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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1940

No. 257

JAY C. HORMEL, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

PETITION FOR CERTIORARI FILED JULY 19, 1940.

CERTIORARI GRANTED OCTOBER 14, 1940.

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United States Circuit Court of Appeals

EIGHTH CIRCUIT.

No. 11,565

TAX REVIEW.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER,

vs.

JAY C. HORMEL, RESPONDENT.

ON PETITION TO REVIEW DECISION OF THE UNITED STATES BOARD OF TAX APPEALS.

FILED AUGUST 16, 1939.

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Pleas and proceedings in the United States Circuit Court of Appeals for the Eighth Circuit, at the March Term, 1940, of said Court, before the Honorable John B. Sanborn, the Honorable Seth Thomas and the Honorable Arba S. Van Valkenburgh, Circuit Judges.

Attest:

E. E. KOCH, Clerk,
Clerk of the United States
Circuit Court of Appeals for
the Eighth Circuit.

(Seal)

Be it Remembered that heretofore, to-wit: on the sixteenth day of August, A. D. 1939, a record on petition to review the decision of the United States Board of Tax Appeals was filed in the office of the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, in a certain matter wherein Guy T. Helvering, Commissioner of Internal Revenue, was Petitioner, and Jay C. Hormel was Respondent, which said record as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, is in the words and figures following, to-wit:

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[fol. 1] Docket Entries.

Jay C. Hormel, Petitioner,
Docket No. 93572. vs.
Commissioner of Internal Revenue, Respondent.

Appearances.

For Taxpayer: H. A. Mihills, Esq.

For Comm'r.: W. Frank Gibbs, Esq.

Transferred to Mr. Murdock 12/16/38.

1938

May 17—Petition received and filed. Taxpayer notified. (Fee paid)

" 17—Request for Circuit hearing in Washington, D. C. filed by taxpayer. 5/18/38 copy served.

" 18—Copy of petition served on General Counsel.

" 20—Answer filed by General Counsel. 5/24/38 copy served.

" 20—Motion to consolidate for hearing with Dockets 89114, 15, and 93571 week beginning June 20, 1938 at St. Paul, Minn. filed by General Counsel.

" 23—Hearing set June 20, 1938 in St. Paul, Minn.

" 24—Notice of filing and hearing motion beginning 6/20/38.

Jun. 27—Hearing had before Mr. Opper on merits. Counsel moves to consolidate with Dockets 89114, 15 and 93571—granted. June 23, 1938 motion to file amended petitions filed in Dockets 89114 and 89115. Copy of each served on respondent. June 27, 1938 answer to amended petitions filed in Dockets 89114 and 89115. Copy served in each on petitioner. Stipulation as to the facts filed in each docket number. Petitioner's brief due 7/27/38—respondent's due August 27, 1938 —reply Sept. 12, 1938.

Aug. 16—Transcript of hearing of June 27, 1938 filed.

" 17—Motion for leave to file the attached brief, brief lodged filed by taxpayer. 8/18/38 granted.

" 18—Copy of motion and brief served on General Counsel.

" 26—Reply brief filed by General Counsel.

1939

Jan. 30—Opinion rendered, John E. Murdock, Div. 3. Decision will be entered under Rule 50.

Mar. 2—Computation of deficiency filed by General Counsel.

" 6—Hearing set March 22, 1939 on settlement.

" 14—Consent to settlement filed by taxpayer.

" 28—Decision entered, J. E. Murdock, Div. 3.

Jun. 17—Petition for review by U. S. Circuit Court of Appeals (8) with assignments of error filed by General Counsel.

" 24—Proof of service filed by General Counsel. (Taxpayer)

" 26—Proof of service filed by General Counsel. (Attorney)

Aug. 4—Praecipe filed with proof of service thereon.

[fol. 2] (Petition of Jay C. Hormel.)

Filed May 17, 1938, U. S. Board of Tax Appeals.

United States Board of Tax Appeals

Jay C. Hormel, Petitioner,
Docket No. 93572. vs.
Commissioner of Internal Revenue, Respondent.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (Bureau symbols IT:D:2 NP-90D) dated February 19, 1938, and as a basis of his proceeding alleges as follows:

1. The petitioner is an individual who maintains his residence at Austin, Minnesota.

2. The notice of deficiency (a copy of which is attached and marked Exhibit A) was mailed to the petitioner on February 19, 1938.

3. The taxes in controversy are Federal income taxes for the calendar years 1934 and 1935 and in the amounts of $8,060.00 and $16,109.70, respectively.

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

(a) The Commissioner has erroneously included in petitioner's gross income for the calendar years 1934 and 1935 the amounts of $15,500.00 and $31,000.00 respectively, representing sums of dividends received by Jay C. Hormel Trusts Nos. 1, 3, 4, and 5.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) On July 16, 1934, petitioner created four trusts which were designated as Jay C. Hormel Trusts Nos. 1, 3, 4, and 5.

(b) To Jay C. Hormel and Park Dougherty, as joint trustees, were transferred shares of Geo. A. Hormel & Co. common stock, 25,000 shares for Trust No. 1 and 2,000 shares each for Trusts Nos. 3, 4, and 5.

(c) Under the terms of the Agreement establishing Trust No. 1, all income of the Trust, but not in excess of $25,000.00 annually, is to be paid to grantor's wife, Germaine D. Hormel. Annual income in excess of $25,000.00 is to be paid to grantor.

[fol. 3] (d) Provision is made for the termination of Trust No. 1 only upon the death of Germaine D. Hormel whereupon the corpus thereof automatically becomes the property of Jay C. Hormel, or of his heirs, in the event he has predeceased his wife.

(e) Under the Trust Agreement, all income received by Trust No. 3, but not exceeding $2,000.00 in any one year, is

to be paid to grantor's son, Geo. A. Hormel, II. To the same extent, the income received by each of Trusts Nos. 4 and 5 is to be paid to grantor's two other sons, Thomas D. Hormel and James C. Hormel, respectively. Income in excess of $2,000.00 received in any one year by either or all of Trusts Nos. 3, 4, and 5 is to be paid to Jay C. Hormel.

(f) The Agreements establishing Trusts Nos. 3, 4, and 5 provide that the income payable to the sons of the grantor shall be paid to Germaine D. Hormel, as guardian.

(g) Under the respective Trust Agreements, each of the three Trusts established for the benefit of petitioner's sons are to terminate at the expiration of three years from and after July 16, 1934, or upon the death of the son named as beneficiary, or at the death of the grantor, whichever occurs first. Upon the termination of said Trusts, the corpus of each is to revert to Jay C. Hormel, grantor, or his heirs.

(h) No provision is contained in any of the Trust Agreements establishing Trusts Nos. 1, 3, 4, and 5 for alteration, amendment, or revocation.

(i) During 1934, Trusts Nos. 1, 3, 4, and 5 received income of $12,500.00, $1,000.00, $1,000.00, and $1,000.00, respectively, and during 1935, income of $25,000.00, $2,000.00, $2,000.00 and $2,000.00, respectively. All of said income was distributed to the beneficiaries in accordance with the terms of the respective Trust Agreements and was included in their Federal income tax returns.

Wherefore, the petitioner prays that this Board may hear the proceeding and determine that petitioner is not subject to Federal income tax on income received by Trusts Nos. 1, 3, 4, and 5 during 1934 and 1935.

H. A. MIHILLS,
Counsel for the Petitioner,
917 Munsey Building,
Washington, D. C.

[fol. 4] State of Minnesota,
County of Mower—ss.

Jay C. Hormel, being duly sworn says that he is the petitioner above named; that he has read the foregoing peti-

tion, or had the same read to him, and is familiar with the statements contained therein, and that the statements contained therein are true.

JAY C. HORMEL.

Subscribed and sworn to before me this 23 day of April, 1938.

J. HELEN TURNER,
Notary Public.

[fol. 5] Exhibit A.

Treasury Department
Washington

February 19, 1938.

Mr. Jay C. Hormel,
Austin, Minnesota.

Sir:

You are advised that the determination of your income tax liability for the taxable years ended December 31, 1934, and 1935, discloses a deficiency of $24,169.70, as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C1:P-7. The signing and filing of this form will expedite the closing of your returns by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period

terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By Chas. T. Russell,
Deputy Commissioner.

Enclosures:
Statement
Form 870

[fol. 6] Statement

IT:D:2
NP-90D

In re: Mr. Jay C. Hormel,
Austin, Minnesota.

Tax Liability for Taxable Years Ended
December 31, 1934, and 1935

Income Tax	Liability	Assessed	Deficiency
1934	$44,212.52	$36,152.52	$ 8,060.00
1935	45,431.65	29,321.95	16,109.70
Totals	$89,644.17	$65,474.47	$24,169.70

In making this determination of your income tax liability, careful consideration has been given to the internal revenue agent's reports dated July 10, 1936, and April 13, 1937, your protest for 1934 dated October 1, 1936, and to the statements made at the conference held on October 20, 1937.

If you do not acquiesce in all of the adjustments making up the deficiency indicated, but desire to stop the accumulation of interest on that part of the deficiency resulting from adjustments to which you agree, please fill out the enclosed form 870, inserting therein the amount of the deficiency you desire to have assessed at once. The execution of the form for the agreed portion of the deficiency will not deprive you of your right to petition the United States Board of Tax Appeals for a redetermination of the deficiency.

Copies of this letter have been mailed to your representatives, Mr. H. C. Utley, First National Soo Line Building, Minneapolis, Minnesota, and Mr. H. A. Mihills, Munsey Building, Washington, D. C., in accordance with the authority contained in the power of attorney executed by you and on file with the Bureau.

Adjustments to Net Income

1934

Net income as disclosed by return	$116,480.70
[fol. 7] Brought forward	$116,480.70
Unallowable deductions and additional income:	
(a) Dividends	15,500.00
Net income adjusted	$131,980.70

Explanation of Adjustment

(a) The revenue agent included in your net income the income of the four trust funds consisting entirely of dividends divided as follows:

	1934
Jay C. Hormel Trust No. 1	$12,500.00
Jay C. Hormel Trust No. 3	1,000.00
Jay C. Hormel Trust No. 4	1,000.00
Jay C. Hormel Trust No. 5	1,000.00
Total	$15,500.00

The revenue agent held such income to be taxable to you as grantor of the above revocable trusts.

The trust agreement of trust No. 1 provides that the trust will terminate upon the death of your wife, Germaine D. Hormel, the beneficiary, at which time the corpus automatically reverts to you or in the event you predecease the beneficiary, to your heirs.

The trust agreements of trusts Nos. 3, 4, and 5, provide that the income shall be paid to your wife, Germaine D. Hormel, as guardian of your three sons (apparent minors), such trusts to terminate at the expiration of three years from July 16, 1934, or upon the death of the son named as beneficiary or at the death of you, the grantor, which-

ever occurs first. The trust agreements further provide that upon the termination of the trusts the corpus automatically reverts to you, the grantor, or to your heirs, if you be deceased.

Section 166 of the Revenue Act of 1934 provides:

"Revocable Trusts.

"Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

"(1) in the grantor, either alone or in conjunction with [fol. 8] any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor."

Since it is the purpose of the Revenue Act of 1934, as provided in section 166, to tax the income to the grantor if at any time in the future the grantor or another not having a substantial adverse interest may, under power specifically vested by the trust instrument, revest title to the corpus of the trust in the grantor, it would seem to follow that the Revenue Act contemplates taxing the income to the grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period.

There is in the opinion of this office no practical difference between the case where a grantor in terms has the power to revest in himself title to the corpus of the trust, and a case such as the instant case where the revesting of the corpus in the grantor in a subsequent year is assured by the express limitation on the terms of the trust indenture. This is the view taken in article 166-1 of Regulations 86, as amended by Treasury Decision 4629, XV-1, Cumulative Bulletin 140 (1936). Such article provides that section 166 of the Revenue Act of 1934 is not to be regarded as excluding from taxation to the grantor of the income of other trusts, not specified therein, in which the

grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. Such article defines "corpus" as "any part or the whole of the property, real or personal, constituting the subject matter of the trust". It contains the following provisions:

"The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to [fol. 9] part permanently and definitively with the substantial incidents of ownership in the corpus.

"In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term: * * * (Underscoring supplied).

"Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make such expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the Trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. * * * (Underscoring supplied).

"(c) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if

he has placed it in trust for his son, John. (underscoring supplied.)

"(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such extension the title is once more to revest in the grantor in possession and enjoyment; * * * (Underscoring supplied.)

[fol. 10] "In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, * * *".

Article 166-1 further provides that the income of the trust is attributed and taxable to the grantor regardless of—

* * * * *

"(a) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

"(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come:

* * * * *"

In view of the above, it is the opinion of this office that, since you, the grantor, may revest title to the corpus of the trusts in yourself if you survive your wife, and at the end of three years with respect to the trusts for the three sons, they are revocable trusts under section 166 of the Revenue Act of 1934 and article 166-1 of Regulations 86 as amended by Treasury Decision 4629, and the income therefrom is taxable to you.

Computation of Tax

1934

Net income adjusted		$131,980.70
Less:		
Personal exemption	$2,500.00	
Credit for 3 dependents	1,200.00	3,700.00
Balance (surtax net income)		$128,280.70

[fol. 11]

Brought forward		$128,280.70
Less:		
Dividends	$89,216.75	
Earned income credit	1,400.00	90,616.75
Net income subject to normal tax		$ 37,663.95
Normal tax at 4% on $37,663.95		$ 1,506.56
Surtax on $128,280.70		42,705.96
Total tax		$ 44,212.52
Corrected income tax liability		$ 44,212.52
Income tax assessed, original, account #200319		36,152.52
Deficiency of income tax		$ 8,060.00

Adjustments to Net Income

1935

Net income as disclosed by return	$103,185.08
Unallowable deductions and additional income:	
(a) Dividends	31,000.00
Net income adjusted	$134,185.08

Explanation of Adjustment

(a) The revenue agent included in your net income the income of the four trust funds consisting entirely of dividends divided as follows:

	1935
Jay C. Hormel Trust No. 1	$25,000.00
Jay C. Hormel Trust No. 3	2,000.00
Jay C. Hormel Trust No. 4	2,000.00
Jay C. Hormel Trust No. 5	2,000.00
Total	$31,000.00

[fol. 12] The revenue agent held such income to be taxable to you as grantor of the above revocable trusts. See explanation for the year 1934 above.

Computation of Tax

1935

Net income adjusted		$134,185.08
Less:		
Personal exemption	$2,500.00	
Credit for 3 dependents	1,200.00	3,700.00
Balance (surtax net income)		$130,485.08
Less:		
Dividends	$89,599.80	
Earned income credit	1,400.00	90,999.80
Net income subject to normal tax		$ 39,485.28
Normal tax at 4% on $39,485.28		$ 1,579.41
Surtax on $130,485.08		43,852.24
Total tax		$ 45,431.65
Corrected income tax liability		$ 45,431.65
Income tax assessed, original, account #200621		29,321.95
Deficiency		$ 16,109.70

[fol. 13] (Answer of Commissioner of Internal Revenue.)

Filed May 20, 1938, United States Board of Tax Appeals.

United States Board of Tax Appeals.

Jay C. Hormel, Petitioner,
Docket No. 93572. vs.
Commissioner of Internal Revenue, Respondent.

Now comes the Commissioner of Internal Revenue, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed in the above-entitled appeal, admits and denies as follows.

1, 2 and 3. Admits the allegations contained in paragraphs 1, 2 and 3.

4. Denies the Commissioner's determination of tax set forth in the deficiency notice is based upon the error alleged in paragraph 4.

5(a) and 5(b). Admits the allegations contained in paragraphs 5(a) and 5(b).

5(c) to 5(h). The allegations of fact contained in paragraphs 5(c) to 5(h) inclusive, relate to what is contained in a written instrument, a true copy of said document not being attached or made a part of the petition. Therefore, said allegations are denied and strict proof of said allegations is respectfully demanded by respondent.

5(i). Admits the allegations contained in paragraph 5(i).

6. Denies generally and specifically each and every allegation contained in taxpayer's petition, not hereinbefore admitted, qualified or denied.

[fol. 14] Wherefore, it is prayed that petitioner's appeal be denied and the respondent's determination be approved.

GWK.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

J. E. Marshall,
W. Frank Gibbs,
Special Attorneys,
Bureau of Internal Revenue.

WFG/dt-May 20/38.

[fol. 15] (Opinion of United States Board of Tax Appeals.)

Copies served on both parties.

United States Board of Tax Appeals.

Jay C. Hormel, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

George A. Hormel, Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket Nos. 89114, 89115, 93571, 93572. Promulgated January 31, 1939.

Income of trusts payable to the grantor's wife for life, with reversion to the grantor or his heirs, and income of trusts for a short period of years payable to the grantor's

wife, as guardian, but "for the use and benefit" of their minor children, held, not taxable to the grantor in the absence of a requirement that the income be used to support, maintain, or educate the beneficiaries.

H. A. Mihills, C. P. A., for the petitioners.

W. Frank Gibbs, Esq., for the respondent.

Opinion.

Murdock: The Commissioner determined deficiencies as follows:

J. C. Hormel

	Year	Deficiency	
		Tax	Amount
Docket No. 89114	1934	Gift tax	$9,044.12
Docket No. 93572	1934	Income tax	8,060.00
Do	1935	Income tax	16,109.70

George A. Hormel

Docket No. 89115	1934	Gift tax	$13,205.70
Docket No. 93571	1935	Income tax	13,780.00

The petitioners created several trusts in 1934 and filed gift tax returns reporting the transfers as subject to gift tax. Thereafter they did not include in their income the income of the trusts, which, under the terms of the trusts, was payable to others. The Commissioner has determined deficiencies in gift tax due to an increased valuation of the stock transferred and, at the same time, he has included the income of the trusts as a part of the income [fol. 16] of the grantors. The parties have agreed upon the value of the stock and the petitioners do not resist a gift tax in case the income is not taxable to them. The respondent seems to concede that the gift tax is due only in case the income is not taxable to the grantors. See Harriet W. Rosenau, 37 B. T. A. 468. The facts have been stipulated and are hereby found in accordance with the stipulation.

J. C. Hormel created a trust on July 16, 1934, and transferred shares of stock to that trust. He named himself and another as co-trustees and provided that all net dividends

up to, but not to exceed, the sum of $25,000 per year, were to be paid to his wife, Germaine D. Hormel, and all excess dividends were to be paid to himself. The trust was to terminate upon the death of the wife, at which time the corpus of the trust was to become the property of the grantor, his heirs, or persons named in his will. The grantor retained no power to revoke, alter, or amend the trust. George A. Hormel created a similar trust in 1934, under which he and his wife Lillian were the beneficiaries.

J. C. Hormel, on July 16, 1934, created three other trusts naming himself and another as trustees, and conveying to each trust some shares of stock. These trusts were similar to the trusts already mentioned with the following exceptions: Dividends up to, but not to exceed, $2,000 per year, in the case of each trust, were to be paid to the grantor's wife as guardian for one of their minor children, and the guardian was to receive the funds "for the use and benefit of" one of the children; excess dividends were to be paid to the grantor; and each trust "shall be automatically revoked and shall terminate at the expiration of three years from and after the date hereof" or upon the earlier death of either of the beneficiaries.

The explanation given in the deficiency notices for taxing to the grantors the income of the trusts which was payable to others, is that section 166 of the Revenue Act of 1934 applies. That section is entitled "Revocable Trusts" and provides:

> Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> (1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
>
> (2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,
>
> then the income of such part of the trust shall be included in computing the net income of the grantor.

Each of these trusts was irrevocable. At no time during the period of the existence of any trust was there vested

[fol. 17] in the grantor, either alone or in conjunction with any other person not having a substantial adverse interest, or in any person not having a substantial adverse interest, a power to revest title to any part of the corpus of the trust in the grantor. The fact that title to the trust corpus was to revest in the grantor or his heirs upon the termination of the trust does not serve to bring it within section 166. John Edward Rovensky, 37 B. T. A. 702; Meredith Wood, 37 B. T. A. 1065; Henry A. B. Dunning, 36 B. T. A. 1222. The trust in the Wood case was for a period of three years. The question of the applicability of section 166 was discussed in the above cited cases and requires no further discussion here. The respondent recognizes that those decisions are against him but argues that they should not be followed. However, we choose to follow them.

The respondent does not suggest that the line of cases beginning with Douglas vs. Willcuts, 296 U. S. 1, has any application to the income of the trusts payable to the wife, but he does argue that the principle of those decisions is applicable in the case of the income of the trusts for the benefit of the children, which income he says is taxable to the grantor under section 167. The Board has already considered a similar contention in the cases of Henry A. B. Dunning, supra, and Ralph L. Gray, 38 B. T. A. 584. We held in those cases that, where a grantor created a trust and provided that the income from the trust was payable to or for the use of a benficiary, without any restriction as to the use which might be made of the income, the income was not taxable to the grantor even though he owed a duty of support, maintenance, or education to the beneficiary. The Circuit Court of Appeals for the Second Circuit took the same view in Shanley vs. Bowers, 81 Fed. (2d) 13. We thus drew a distinction between such cases and cases like Douglas vs. Willcuts, supra; Helvering vs. Schweitzer, 296 U. S. 551; Helvering vs. Blumenthal, 296 U. S. 552; Helvering vs. Coxey, 297 U. S. 694; Helvering vs. Grosvenor, 85 Fed. (2d) 2, where the grantor expressly required that the income be used to discharge some obligation which he owed to the recipient. No authority is cited which has held that income is taxable to a grantor where he has failed to require that it be used to discharge an obligation of his. Cf. Hudson vs. Jones, 22 Fed. Supp. 938; E. E. Black, 36 B. T. A. 346; Martin F. Tiernan, Trustee, 37 B. T. A. 1048.

The trust instrument in the Gray case provided that the corpus of the trust was to be divided into three equal parts; one called the wife's share, another called the son's share, and another called the daughter's share. The following provision of the instrument relates to the use which was to be made of the income from the son's share until he reached [fol. 18] the age of 22, and there was a similar provision in regard to the income from the daughter's share:

The net income from the Son's Share shall be paid, quarter-annually as nearly as practicable, to the said Anna Marie Gray until such time as the son of the Settlor, Stewart Sill Gray, shall reach the age of twenty-two (22) years or until the death of the said Stewart Sill Gray if the said Stewart Sill Gray shall die before reaching the age of twenty-two (22) years, provided that if prior thereto, the said Anna Marie Gray shall die or the marriage relation between the said Anna Marie Gray and the Settlor shall be terminated, then from and after the date of her death or the date of such termination of said marriage relation, the net income shall be paid and/or expended for the benefit of the said son of the Settlor, Stewart Sill Gray, and/or accumulated all as hereinafter provided. So long as the said Stewart Sill Gray shall remain a minor, the Trustee shall have the discretion to pay the net income or such part thereof as the Trustee in his, its or their discretion shall determine and at such periods and in such installments as the Trustee in his, its or their discretion shall determine, to the natural guardian or the testamentary guardian or any other guardian or curator of the said Stewart Sill Gray and/or to expend so much thereof as the Trustee in his, its or their discretion shall determine for the use and benefit of the said Stewart Sill Gray and/or to accumulate so much of the net income as the Trustee in his, its or their discretion shall determine, such accumulated income, if any, to be later distributed or expended or to become a part of the principal of the Son's Share as the Trustee in his, its or their discretion shall determine. The Trustee's determination shall be final and conclusive upon all parties interested in the Trust Estate.

The income of the children's shares was to be paid to them directly after they became 22 years of age, and there were provisions for distribution of the principal to them

also. We held that the income was not taxable to the grantor.

The grantor here merely left the income for the use and benefit of his minor children. It is difficult to conceive how he could have placed less restriction on its use and at the same time have indicated that it was to be theirs alone. He did not require that the income be used for their maintenance, support, or education. Thus, it could have been used freely in any way whatsoever for their use and benefit, without violating the terms of the trust instrument. Although the present record does not show whether or not any of the income was actually used for their support, maintenance, and education, that circumstance is important only in contrast with the Dunning and Gray cases, where it appeared affirmatively that some of the income had been used voluntarily by the recipients for the support, maintenance, or education of the grantors' wives or children, and we nevertheless held that the income was not taxable to the grantor. We held, following the Dunning and Gray cases, that the income of these trusts was not taxable to the grantor. Cf. John Edward Rovensky, supra.

Cases have been presented to the Board involving trusts created for short periods where the grantor has reserved [fol. 19] to himself practically all of the substantial benefits as owner of the property, and the Board has held that such trusts are lacking in substance to such an extent that the income is taxable to the grantor. See Estate of A. C. O'Laughlin, 38 B. T. A. 1120, and cases there cited. The respondent does not argue that those cases are applicable here and obviously they are not, because here the trusts were not lacking in substance during the three years of their existence. In the case of each of these trusts the income was actually paid in accordance with the provisions of the trust instrument. They did not leave to the grantor any substantial rights and interest in, control over, or management of the trust property during the existence of the trusts. The grantor could not use the trust property for his own benefit or enjoyment. Thus, these trusts can not be disregarded and it can not be said that they fall within section 167 because a part of the income of the trusts might be distributed to the grantor or held for future distribution to him.

Reviewed by the Board.

Decisions will be entered under Rule 50.

Opper, dissenting: Section 167, Revenue Act of 1934, provides:

(a) Where any part of the income of a trust—

* * * * * *

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;

* * * * * *

then such part of the income of the trust shall be included in computing the net income of the grantor.

A distribution for the grantor's benefit, as for example the payment of an obligation of support owed by him, is the equivalent of a distribution to him. Douglas vs. Willcuts, 296 U. S. 1; Helvering vs. Coxey, 297 U. S. 694; Commissioner vs. Grosvenor, 85 Fed. (2d) 2. Regulations 86 issued under the 1934 Act is declaratory of the same principle.[1]

[fol. 20] The wife here has no interest adverse to petitioner in the distribution of the income from the children's trusts. Reinecke vs. Smith, 289 U. S. 172. As the major-

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[1] ART. 167-1. *Trusts in the income of which the grantor retains an interest.*—

* * * * * * *

(b) * * * The test of the sufficiency of the grantor's retained interest in the trust income, * * * is whether the grantor has failed to divest himself, * * * of every right which might, by any possibility, enable him to have the income, at some time, distributed to him, actually or constructively. * * *

* * * * * * *

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

* * * * * * *

(4) whether, if such distribution results in the inuring of benefits to the grantor from the application of the income in satisfaction of his legal obligation, such obligation is * * *, to support dependents, * * * to furnish maintenance, and support or otherwise;

* * * * * * *

ity opinion concedes, she could have expended it for the support of the grantor's infant children, for which he was responsible, Knutson vs. Haugen, 191 Mich. 420; 254 N. W. 464, with no resulting violation of her trust. Gasquet vs. Pollock, 1 (N. Y.) App. Div. 512; 37 N. Y. S. 357; see Bird vs. Newcomb (Va. 1938), 196 S. E. 605, and cases there cited. And if she did so it is clear as it was in E. E. Black, 36 B. T. A. 346; Martin F. Tiernan, 37 B. T. A. 1048, Hudson vs. Jones, 22 Fed. Supp. 938, and Commissioner vs. Grosvenor, supra, that to that extent at least the discharge of an obligation of the grantor would require that the income be treated as his. The petitioner "was responsible for the minor children's maintenance and support, so that the transfer * * * correspondingly relieved him of his statutory duty. Such relief made him, to that extent, a beneficiary. Savage vs. Commissioner (C. C. A.) 82 Fed. (2d) 92." Clark vs. Commissioner (C. C. A., 3d Cir.), 84 Fed. (2d) 725, 726.

The trusts for the benefit of petitioner's children thus fall squarely within the terms of the statute, as it has been construed, and of respondent's regulation. The statutory requirement that one thus benefited shall be taxed on that benefit has been relieved only to a limited degree; that is the extent to which a petitioner can show, first, that there was no agreement express or implied by the grantor and the guardian or trustee that any part of the income should be devoted to the discharge of the grantor's obligation of support, Henry A. B. Dunning, 36 B. T. A. 1222, 1231, 1232; and, second, that even if there be no such agreement the avails of the trust have not in fact been applied to any such purpose. E. E. Black, supra; Martin F. Tiernan, supra. While it may be conceded that there was no express provision in the trust deed, requiring that the income be spent to benefit the grantor, that was possible in the wife's discretion. On the authority of the cases last cited that evidence, of which the majority so easily disposes, was accordingly the pivotal, the controlling issue. For the sole fact which would foreclose a determination in favor of respondent would be that actually no part of the trust income was so used, a fact which, like any other, could have been proved, by petitioner. His omission leads logically to the inference that it was not the fact, and legally to the result that

his failure of proof requires affirmance of the respondent's determination. Commissioner vs. Grosvenor, supra.

This decision, therefore, seems to be nothing more than an overruling of the Black and Tiernan cases in favor of the supposed doctrine of Ralph L. Gray, 38 B. T. A. 584 [fol. 21] and Henry A. B. Dunning, supra. The confusion and inequity inevitable in any such result may be demonstrated by what has actually occurred in the history of those very proceedings. Not only was acquiescence in the Black decision announced by respondent (1937—2 C. B. 3), but on the strength of that decision respondent's counsel published an opinion to the effect that such trust income is taxable to the grantor only to the extent that it is actually distributed for the support of those to whom the grantor owes that duty. 1937—2 C. B. 231, G. C. M. 18972. And that opinion has been cited as authority by at least one District Court in a case very similar to this. Hudson vs. Jones, 22 Fed. Supp. 938.

Finally, the proposed conclusion finds no support in the Dunning and Gray cases on which the majority relies. The contrast made fundamental by the statute between the discretion of a beneficiary and that of a fiduciary, see Reinecke vs. Smith, supra, furnishes a complete distinction from anything in those cases, which, at least in their published form, are identical with each other in their facts and conclusions. The finding in the Gray case (p. 585) that "There is no provision anywhere in the trust instrument designating the manner in which any of the income shall be expended by the wife", is controlling, regardless of the unpublished record reproduced and reconstrued in the prevailing opinion. The San Simeon (C. C. A., 2d Cir.), 63 Fed. (2d) 798, 802. Thus, in both the Dunning and Gray cases the application of the income resided in the discretion of the wife, who was the beneficiary. That she chose to apply some part of the income to the expenses of the household was immaterial because the statute never came into operation. Her discretion was that of a person with "a substantial adverse interest." Here the wife, in whose discretion the income can be applied for the grantor's benefit, has no interest whatever adverse to the grantor.

The majority is quite evidently confusing the two independent factors which must be considered in cases of this

kind. It can not hold that payment of the children's maintenance is not constructive receipt by the grantor without disregarding Douglas vs. Willcuts, supra. On the other hand, it can not, without violating the express language of section 167, hold that such distribution to the grantor, being the result of a discretion exercised by one not adversely interested, is not taxable to the grantor. But it is enabled to reach its desired result by applying to a decision of the first question—the Douglas vs. Willcuts principle—cases where only the second question was involved, Henry A. B. Dunning and Ralph L. Gray, supra; and by disregarding the cases where the relevant issue was considered, E. E. Black and Martin F. Tiernan, supra.

For the reasons stated I am compelled to note my dissent from that part of the majority opinion which holds [fol. 22] that the income from the trusts for the benefit of the children is not taxable to petitioner. Had the opposite result been reached it would have been unnecessary to consider the further question of the effect of the short period for which these trusts were created. On this point I have grave doubts of the correctness of the prevailing opinion and it seems to me it is contrary to what we said not so long ago in Frances Marshall Canfield et al., Executors, 31 B. T. A. 724.

Turner, Mellott, Hill, Disney, Harron, and Kern agree with this dissent.

(Seal of U. S. Board of
Tax Appeals.)

[fol. 23] (Order of Redetermination, March 28, 1939.)

United States Board of Tax Appeals.

Jay C. Hormel, Petitioner,
Docket Nos. 89114, 93572 vs.
Commissioner of Internal Revenue, Respondent.

Decision.

The respondent, on March 2, 1939, filed a proposed computation pursuant to the Board's Opinion promulgated January 31, 1939. The petitioner, on March 14, 1939, filed

a notice of acquiescence to the respondent's computation, Therefore, it is

Ordered and Decided, that there is a deficiency in gift tax for the year 1934 in the amount of $4,570.27, and that there are no deficiencies in income tax for the year 1934 and 1935.

J. E. MURDOCK,
Member, United States
Board of Tax Appeals.

Enter:
Entered
March 28, 1939.

Seal
U. S. Board of
Tax Appeals
1924

[fol. 24] (Petition of Guy T. Helvering, Commissioner of Internal Revenue, for Review of Decision of United States Board of Tax Appeals.)

Filed June 17, 1939, United States Board of Tax Appeals.

In the United States Circuit Court of Appeals for the Eighth Circuit.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner on Review,
B. T. A. Docket No. 93,572 vs.
Jay C. Hormel, Respondent on Review.

To the Honorable Judges of the United States Circuit Court of Appeals for the Eighth Circuit:

Now Comes Guy T. Helvering, Commissioner of Internal Revenue, by his attorneys, James W. Morris, Assistant Attorney General, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and Ralph F. Staubly, Special Attorney, Bureau of Internal Revenue, and respectfully shows:

I.

That he is the duly appointed, qualified and acting Commissioner of Internal Revenue, appointed and holding office by virtue of the laws of the United States; that Jay C.

Hormel (hereinafter referred to as the taxpayer), an individual, resides at Austin, Mower County, Minnesota; and that the income tax returns made by the taxpayer for the years 1934 and 1935, were filed with the Collector of Internal Revenue for the District of Minnesota, whose office is located in St. Paul, Minnesota, which is within the jurisdiction of the United States Circuit Court of Appeals for the Eighth Circuit.

[fol. 25] The Court in which the review of this proceeding is sought is the United States Circuit Court of Appeals for the Eighth Circuit.

II.

The nature of the controversy is as follows, to-wit:

The income tax returns filed by the taxpayer for the years 1934 and 1935 disclosed tax liabilities of $36,152.52 and $29,321.95, respectively. On July 16, 1934 the taxpayer established three short term trusts, known as the J. C. Hormel Trusts Numbers 3, 4 and 5. The income from said trusts was to be expended in the interest of the taxpayer's children, George A. Hormel, II, Thomas D. Hormel and James C. Hormel, as beneficiaries.

Under date of February 19, 1938 the Commissioner of Internal Revenue mailed a notice to the taxpayer, asserting deficiencies in his income tax liabilities for the years 1934 and 1935 in the amounts of $8,060.00 and $16,109.70, respectively. In determining said deficiencies the Commissioner included in the taxpayer's gross income for said years, the income from the aforesaid trusts.

Under date of May 17, 1938, the taxpayer filed a petition with the United States Board of Tax Appeals for a redetermination of the deficiencies in the tax, as determined by the Commissioner of Internal Revenue. After the answer of the Commissioner was filed, the case was duly submitted to the Board of Tax Appeals for decision. The interlocutory opinion and decision of the Board was pro-
[fol. 26] mulgated on January 31, 1939 and the final order of the Board, redetermining the deficiencies, was entered on March 28, 1939, in which it was ordered and decided that there were no deficiencies in income tax for the years 1934 and 1935.

The Board of Tax Appeals, in redetermining the deficiencies in tax as aforesaid, held and decided that the income from the aforesaid short term trusts, was not subject to be included in the gross income of the taxpayer for the years 1934 and 1935.

III:

The Commissioner of Internal Revenue being aggrieved by the conclusions of law contained in the decision of the Board of Tax Appeals and by its order of redetermination, desires to obtain a review thereof by the United States Circuit Court of Appeals for the Eighth Circuit.

The Commissioner's assignments of errors are as follows:

1. The Board of Tax Appeals erred in holding and deciding that the income from Trusts 3, 4 and 5, executed by the taxpayer on July 16, 1934, in the interest of his three sons as beneficiaries, was not subject to be included in the taxpayer's gross income for the years 1934 and 1935.

2. The Board of Tax Appeals erred in not holding and deciding that the income from Trusts 3, 4 and 5, as aforesaid, was subject to be included in the gross income of the taxpayer for the years 1934 and 1935, pursuant to the provisions of Section 166 of the Revenue Act of 1934.

3. The Board of Tax Appeals erred in not holding and deciding that the income from Trusts 3, 4 and 5, aforesaid, [fol. 27] was subject to be included in the gross income of the taxpayer for the years 1934 and 1935, pursuant to the provisions of Section 167 of the Revenue Act of 1934.

4. The Board of Tax Appeals erred in entering its final order of redetermination that there are no deficiencies in tax for the years 1934 and 1935.

5. The Board of Tax Appeals erred in failing and refusing to enter a final order of redetermination that there are deficiencies in the tax for the years 1934 and 1935 in the respective amounts of tax attributable to the inclusion in the gross income of the taxpayer of the income from the aforesaid trusts, expendable in the interest of the beneficiaries during said years.

6. The Board of Tax Appeals erred in that its decision is not supported by the evidence and is contrary to law.

Wherefore, the Commissioner petitions that the decision of the Board of Tax Appeals be reviewed by the United States Circuit Court of Appeals for the Eighth Circuit, that a transcript of the record be prepared in accordance with law and with the rules of said Court and transmitted to the Clerk of said Court for filing, and that appropriate action be taken to the end that the errors complained of may be reviewed and corrected by said Court.

JAMES W. MORRIS,
Assistant Attorney General.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Of Counsel:

Ralph F. Staubly,
Special Attorney,
Bureau of Internal Revenue.

RFS-spt 6-17-39

[fol. 28] United States of America,
District of Columbia—ss.:

Ralph F. Staubly, being duly sworn, says that he is a Special Attorney in the Bureau of Internal Revenue, and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

RALPH F. STAUBLY,
Special Attorney, Bureau of Internal Revenue.

Sworn and subscribed to before me this 17th day of June, 1939.

MARCELLETTE TAYLOR,
Notary Public.

My commission expires April 1, 1940.

[fol. 29] (Notice of filing of Petition for Review and Service on Counsel for Respondent on Review.)

(Received and Filed June 24, 1939, United States Board of Tax Appeals.)

To:

H. A. Mihills, Esq.,
917 Munsey Bldg.,
Washington, D. C.

You are hereby notified that the Commissioner of Internal Revenue did, on the 17th day of June, 1939, file with the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 17th day of June, 1939.

RLW

J. P. WENCHEL,
Chief Counsel, Bureau of
Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein is hereby acknowledged this 20th day of June, 1939.

H. A. MIHILLS,
Attorney for Respondent on Review.

[fol. 30] (Notice of filing of Petition for Review and Service on Respondent on Review.)

(Received and Filed June 26, 1939, United States Board of Tax Appeals.)

To:

Jay C. Hormel,
Austin, Mower County, Minnesota.

You are hereby notified that the Commissioner of Internal Revenue did, on the 17th day of June, 1939, file with

the Clerk of the United States Board of Tax Appeals, at Washington, D. C., a petition for review by the United States Circuit Court of Appeals for the Eighth Circuit, of the decision of the Board heretofore rendered in the above-entitled case. A copy of the petition for review and the assignments of error as filed is hereto attached and served upon you.

Dated this 17th day of June, 1939.

RLW

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of errors mentioned therein is hereby acknowledged this 20 day of June, 1939.

JAY C. HORMEL,
Respondent on Review.

[fol. 31] Stipulation of Facts.

(Filed at Hearing June 27, 1938, U. S. Board of Tax Appeals.)

United States Board of Tax Appeals

Jay C. Hormel, Petitioner,
Docket Nos. 89114 and 93572. vs.
Commissioner of Internal Revenue, Respondent.

It is hereby stipulated by and between the parties hereto by their respective attorneys of record that, for the purpose of this proceeding only, the following facts shall be taken as true and that the exhibits referred to herein and annexed hereto are hereby made a part of this stipulation and the facts therein stated shall be taken as true; and,

It is further stipulated and agreed that this stipulation shall be without prejudice to the right of either party to introduce further proof deemed material and pertinent and not in conflict with the facts here stipulated.

(1) The petitioner is an individual who is an officer of, and whose business address is c/o Geo. A. Hormel & Co., Austin, Minnesota.

(2) On July 16, 1934, petitioner transferred, as gifts in trust, 31,000 shares of common stock of Geo. A. Hormel & Co. (a Delaware corporation).

* * * * * * *

[fol. 32] (5) On July 16, 1934, petitioner created four trusts which were designated as Jay C. Hormel Trusts Nos. 1, 3, 4 and 5.

(6) To Jay C. Hormel and Park Dougherty, as joint trustees, were transferred shares of Geo. A. Hormel & Co. common stock, 25,000 shares for Trust No. 1 and 2,000 shares each for Trusts Nos. 3, 4 and 5, comprising the 31,000 shares referred to in paragraph (2) above, all of which more particularly appears by reference to Exhibits A, B, C, and D respectively, attached hereto and made a part hereof.

(7) During 1934, Trusts Nos. 1, 3, 4 and 5 received income of $12,500.00, $1,000.00, $1,000.00, and $1,000.00, respectively, and during 1935, income of $25,000.00, $2,000.00, $2,000.00, and $2,000.00, respectively. All of said income was distributed to the beneficiaries in accordance with the terms of the respective Trust Agreements and was included in their Federal income tax returns.

* * * * * * *

[fol. 33] (10) For income tax purposes the sole question involved for the Board to decide is whether any or all the items of income set forth in paragraph 7 of this stipulation are taxable to petitioner as determined by the respondent.

* * * * * * *

H. A. MIHILLS,
Counsel for Petitioner.
W.F.G.

J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue,
Counsel for Respondent.

[fol. 34] Exhibit B.

Agreement and Declaration of Trust No. 3.

The undersigned Jay C. Hormel does hereby create and declare the following described trust in the undersigned Park Dougherty and himself as co-trustees for the benefit of Jay C. Hormel, and Germaine D. Hormel, his wife, as guardian for their son George A. Hormel II. Jay C. Hormel is the owner of the securities listed in the attached schedule marked Exhibit A. He hereby agrees that said co-trustees shall receive and hold said securities and collect the dividends therefrom as a trust estate in trust for Germaine D. Hormel, as guardian of George A. Hormel II, and Jay C. Hormel, as sole beneficiaries, upon the terms and conditions following:

1. All the dividends from the trust estate received during the continuance of the trust hereby created shall be paid by the co-trustees to the beneficiaries on receipt thereof as follows: To Germaine D. Hormel, as guardian aforesaid, for the use and benefit of George A. Hormel II, all net dividends up to but not to exceed the sum of $2,000 per year from date hereof, and to Jay C. Hormel all net dividends in excess thereof.

2. Upon the termination of the trust the entire principal or corpus thereof shall be deemed and treated as property owned absolutely by Jay C. Hormel as of the same time, free and clear of all terms of this trust, and in the event of his decease previous thereto the share that would have reverted to him shall revert to the legatees and devisees of his last will and testament, or to his heirs at law should he leave no will.

3. During the continuance of the trust hereby created, the co-trustees shall retain and have full power and au- [fol. 35] thority to appoint proxies to exercise any and all voting powers under any certificates or shares of stock in the trust estate. The resignation of Park Dougherty as co-trustee may be required by the beneficiaries. In that event, or should he for any other reason be unable to act, his successor shall be chosen by agreement between Jay C. Hormel and Germaine D. Hormel, as guardian aforesaid.

4. Said trustees shall not be liable or responsible to the beneficiary Germaine D. Hormel, as guardian aforesaid, or to George A. Hormel II for any loss of any kind except in consequence of the wilful and deliberate violation of their duties as trustees herein.

5. Except as otherwise herein provided specifically to the contrary, no title in or to the trust estate or any dividends therefrom shall vest in the beneficiary Germaine D. Hormel, as guardian, or in George A. Hormel II, and neither the principal nor any future dividends shall be liable or in any manner chargeable for their debts and they shall have no power to sell, transfer, encumber or in any manner anticipate or dispose of any interest in the trust estate or any dividends therefrom prior to actual payment or delivery thereof by said trustees to said Germaine D. Hormel as guardian aforesaid.

6. The trust hereby created shall be automatically revoked and shall terminate at the expiration of three years from and after the date hereof or upon the death of the beneficiary George A. Hormel II or upon the death of Jay C. Hormel, whichever event occurs first. At no time before the termination of the trust shall said Jay C. Hormel or said co-trustees have the power to re-vest in Jay C. Hormel as beneficial owner any part of the corpus or prin-
[fol. 36] cipal of the trust or trust estate or the income therefrom other than as herein provided, or to revoke, alter or amend this instrument or the trust hereby ceated.

7. The word dividends herein shall be construed to include other income in event the stock certificates deposited at the inception of the trust are sold or substituted by securities other than dividend-bearing stock.

8. The co-trustees shall have power to pay out of the income such reasonable expenses as may be from time to time incurred in administering the trust. Jay C. Hormel shall receive no pay for services as trustee. His co-trustee shall be paid quarterly out of the income such reasonable sums for services as may be agreed upon between the trustees and the beneficiaries.

In Witness Whereof, We have hereto set our hands this 16th day of July, 1934.

JAY C. HORMEL,
PARK DOUGHERTY.

Signed in the Presence of:
Lydia Safranek
S. D. Catherwood

State of Minnesota,
County of Mower—ss.

On this 16th day of July, 1934, before me, a Notary Public within and for said County, personally appeared Jay C. Hormel and Park Dougherty, to me known to be the persons described in and who executed the foregoing instrument, and acknowledged that they executed the same as their voluntary act and deed.

(Signed and stamped) LYDIA SAFRANEK,
(Seal) Notary Public, Mower County, Minn.

My commission expires Sept. 1, 1937.

* * * * * *

[fol. 37] I, Germaine D. Hormel, as guardian on behalf of George A. Hormel II, the beneficiary named in the foregoing instrument, hereby acknowledge notice of the execution thereof and receipt of a true copy thereof.

Dated July 16, 1934.

GERMAINE D. HORMEL,
As Guardian of George A. Hormel II.

[fol. 38] Exhibit C.

Agreement and Declaration of Trust No. 4.

The undersigned Jay C. Hormel does hereby create and declare the following described trust in the undersigned Park Dougherty and himself as co-trustees for the benefit of Jay C. Hormel, and Germaine D. Hormel, his wife, as guardian for their son Thomas D. Hormel. Jay C. Hormel is the owner of the securities listed in the attached schedule marked Exhibit A. He hereby agrees that said co-trustees shall receive and hold said securities and collect the

dividends therefrom as a trust estate in trust for Germaine D. Hormel, as guardian of Thomas D. Hormel, and Jay C. Hormel, as sole beneficiaries, upon the terms and conditions following:

1. All the dividends from the trust estate received during the continuance of the trust hereby created shall be paid by the co-trustees to the beneficiaries on receipt thereof as follows: To Germaine D. Hormel, as guardian aforesaid, for the use and benefit of Thomas D. Hormel, all net dividends up to but not to exceed the sum of $2,000 per year from date hereof, and to Jay C. Hormel all net dividends in excess thereof.

2. Upon the termination of the trust the entire principal or corpus thereof shall be deemed and treated as property owned absolutely by Jay C. Hormel as of the same time, free and clear of all terms of this trust, and in the event of his decease previous thereto the share that would have reverted to him shall revert to the legatees and devisees of his last will and testament, or to his heirs at law should he leave no will.

3. During the continuance of the trust hereby created, the co-trustees shall retain and have full power and au- [fol. 39] thority to appoint proxies to exercise any and all voting powers under any certificates or shares of stock in the trust estate. The resignation of Park Dougherty as co-trustee may be required by the beneficiaries. In that event, or should he for any other reason be unable to act, his successor shall be chosen by agreement between Jay C. Hormel and Germaine D. Hormel, as guardian aforesaid.

4. Said trustees shall not be liable or responsible to the beneficiary Germaine D. Hormel, as guardian aforesaid, or to Thomas D. Hormel for any loss of any kind except in consequence of the wilful and deliberate violation of their duties as trustees herein.

5. Except as otherwise herein provided specifically to the contrary, no title in or to the trust estate or any dividends therefrom shall vest in the beneficiary Germaine D. Hormel, as guardian, or in Thomas D. Hormel, and neither the principal nor any future dividends shall be liable or in any manner chargeable for their debts and they shall have

no power to sell, transfer, encumber or in any manner anticipate or dispose of any interest in the trust estate or any dividends therefrom prior to actual payment or delivery thereof by said trustees to said Germaine D. Hormel as guardian aforesaid.

6. The trust hereby created shall be automatically revoked and shall terminate at the expiration of three years from and after the date hereof or upon the death of the beneficiary Thomas D. Hormel or upon the death of Jay C. Hormel, whichever event occurs first. At no time before the termination of the trust shall said Jay C. Hormel or said co-trustees have the power to re-vest in Jay C. Hormel as beneficial owner any part of the corpus or principal of the trust or trust estate or the income therefrom other than as herein provided, or to revoke, alter or amend this instrument or the trust hereby created.

[fol. 40] 7. The word dividends herein shall be construed to include other income in event the stock certificates deposited at the inception of the trust are sold or substituted by securities other than dividend-bearing stock.

8. The co-trustees shall have power to pay out of the income such reasonable expenses as may be from time to time incurred in administering the trust. Jay C. Hormel shall receive no pay for services as trustee. His co-trustee shall be paid quarterly out of the income such reasonable sums for services as may be agreed upon between the trustees and the beneficiaries.

In Witness Whereof, We have hereto set our hands this 16th day of July, 1934.

JAY C. HORMEL,
PARK DOUGHERTY.

Signed in the Presence of:
Lydia Safranek
S. D. Catherwood

State of Minnesota,
County of Mower—ss:

On this 16th day of July, 1934, before me, a Notary Public within and for said County, personally appeared Jay C. Hormel and Park Dougherty, to me known to be the persons described in and who executed the foregoing in-

strument, and acknowledged that they executed the same as their voluntary act and deed.

LYDIA SAFRANEK,
(Seal) Notary Public, Mower County, Minn.

My commission expires Sept. 1, 1937.

* * * * * * * *

I, Germaine D. Hormel, as guardian on behalf of Thomas D. Hormel, the beneficiary named in the foregoing instrument, hereby acknowledge notice of the execution thereof and receipt of a true copy thereof.

Dated July 16, 1934.

GERMAINE D. HORMEL,
As Guardian of Thomas D. Hormel.

[fol. 41] Exhibit D.

Agreement and Declaration of Trust No. 5.

The undersigned Jay C. Hormel does hereby create and declare the following described trust in the undersigned Park Dougherty and himself as co-trustees for the benefit of Jay C. Hormel, and Germaine D. Hormel, his wife, as guardian for their son James C. Hormel. Jay C. Hormel is the owner of the securities listed in the attached schedule marked Exhibit A. He hereby agrees that said co-trustees shall receive and hold said securities and collect the dividends therefrom as a trust estate in trust for Germaine D. Hormel, as guardian of James C. Hormel, and Jay C. Hormel, as sole beneficiaries, upon the terms and conditions following:

1. All the dividends from the trust estate received during the continuance of the trust hereby created shall be paid by the co-trustees to the beneficiaries on receipt thereof as follows: To Germaine D. Hormel, as guardian aforesaid, for the use and benefit of James C. Hormel, all net dividends up to but not to exceed the sum of $2,000 per year from date hereof, and to Jay C. Hormel all net dividends in excess thereof.

2. Upon the termination of the trust the entire principal or corpus thereof shall be deemed and treated as

property owned absolutely by Jay C. Hormel as of the same time, free and clear of all terms of this trust, and in the event of his decease previous thereto the share that would have reverted to him shall revert to the legatees and devisees of his last will and testament, or to his heirs at law should he leave no will.

3. During the continuance of the trust hereby created, the co-trustees shall retain and have full power and authority to appoint proxies to exercise any and all voting, [fol. 42] powers under any certificates or shares of stock in the trust estate. The resignation of Park Dougherty as co-trustee may be required by the beneficiaries. In that event, or should he for any other reason be unable to act, his successor shall be chosen by agreement between Jay C. Hormel and Germaine D. Hormel, as guardian aforesaid.

4. Said trustees shall not be liable or responsible to the beneficiary Germaine D. Hormel, as guardian aforesaid, or to James C. Hormel for any loss of any kind except in consequence of the wilful and deliberate violation of their duties as trustees herein.

5. Except as otherwise herein provided specifically to the contrary, no title in or to the trust estate or any dividends therefrom shall vest in the beneficiary Germaine D. Hormel, as guardian, or in James C. Hormel, and neither the principal nor any future dividends shall be liable or in any manner chargeable for their debts and they shall have no power to sell, transfer, encumber or in any manner anticipate or dispose of any interest in the trust estate or any dividends therefrom prior to actual payment or delivery thereof by said trustees to said Germaine D. Hormel as guardian aforesaid.

6. The trust hereby created shall be automatically revoked and shall terminate at the expiration of three years from and after the date hereof or upon the death of the beneficiary James C. Hormel or upon the death of Jay C. Hormel, whichever event occurs first. At no time before the termination of the trust shall said Jay C. Hormel or said co-trustees have the power to re-vest in Jay C. Hormel as beneficial owner any part of the corpus or principal of the trust or trust estate or the income therefrom other

than as herein provided, or to revoke, alter or amend this instrument or the trust hereby created.

[fol. 43] 7. The word dividends herein shall be construed to include other income in event the stock certificates deposited at the inception of the trust are sold or substituted by securities other than dividend-bearing stock.

8. The co-trustees shall have power to pay out of the income such reasonable expenses as may be from time to time incurred in administering the trust. Jay C. Hormel shall receive no pay for services as trustee. His co-trustee shall be paid quarterly out of the income such reasonable sums for services as may be agreed upon between the trustees and the beneficiaries.

In Witness Whereof, We have hereto set our hands this 16th day of July, 1934.

JAY C. HORMEL,
PARK DOUGHERTY.

Signed in the Presence of:
Lydia Safranek
S. D. Catherwood

State of Minnesota,
County of Mower—ss:

On this 16th day of July, 1934, before me, a Notary Public within and for said County, personally appeared Jay C. Hormel and Park Dougherty, to me known to be the persons described in and who executed the foregoing instrument, and acknowledged that they executed the same as their voluntary act and deed.

LYDIA SAFRANEK,
(Seal) Notary Public, Mower County, Minn.

My commission expires Sept. 1, 1937.

* * * * * * * *

I, Germaine D. Hormel, as guardian on behalf of James C. Hormel, the beneficiary named in the foregoing instrument, hereby acknowledge notice of the execution thereof and receipt of a true copy thereof.

Dated July 16, 1934.

GERMAINE D. HORMEL,
As Guardian of James C. Hormel.

[fol. 44] (Praecipe for Transcript.)

(Received and Filed August 4, 1939, United States Board of Tax Appeals.)

To the Clerk of the United States Board of Tax Appeals:

You will please prepare, transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, copies duly certified as correct of the following documents and records in the above-entiled cause in connection with the petition for review by the said Circuit Court of Appeals for the Eighth Circuit, heretofore filed by the Commissioner of Internal Revenue:

1. Docket entries of the proceedings before the Board;

2. Pleadings before the Board,

(a) Petition, including annexed copy of deficiency letter.

(b) Answer.

3. Opinion and decision of the Board.

4. Petition for review, together with proof of service of notice of filing petition for review and of service of a copy of petition for review.

5. Stipulation of facts filed June 27, 1938, including Exhibits "B", "C" and "D" attached thereto, but ex-
[fol. 45] cluding paragraphs 3, 4, 8, 9 and 11, and Exhibit "A" thereof, which such excluded paragraphs and exhibit are irrelevant and immaterial to the issues on review.

6. Order enlarging time for the preparation of the evidence and for the transmission and delivery of the record.

7. This praecipe.

J. P. WENCHEL, R
Chief Counsel, Bureau of Internal Revenue.

Service of a copy of the within praecipe is hereby admitted this 3rd day of August, 1939.

H. A. MIHILLS,
Attorney for Respondent on Review.

spt. 7-31-39

[fol. 46] (Clerk's Certificate to Transcript.)

United States Board of Tax Appeals

Washington

Commissioner of Internal Revenue, Petitioner,
Docket No. 93572 vs.
Jay C. Hormel, Respondent.

I, B. D. Gamble, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 45, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal as above numbered and entitled.

Seal
U. S. Board of
Tax Appeals
1924

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 14th day of August, 1939.

B. D. GAMBLE,
Clerk, United States Board of Tax Appeals.

Filed Aug. 16, 1939, E. E. Koch, Clerk.

[fol. 40] And thereafter the following proceedings were had in said cause in the Circuit Court of Appeals, viz.:

(Appearance of Mr. J. P. Wenchel and Mr. Ralph F. Staubly as Counsel for Petitioner.)

United States Circuit Court of Appeals,
Eighth Circuit.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,
No. 11565 vs.
Jay C. Hormel.

The Clerk will enter our appearance as Counsel for the Petitioner.

J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue.

RALPH F. STAUBLY,
Special Attorney, Bureau of Internal Revenue.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Aug. 21, 1939.

[fol. 41] (Appearance of Mr. Samuel O. Clark, Jr., and Mr. Sewall Key as Counsel for Petitioner.)

The Clerk will enter my appearance as Counsel for the Petitioner.

SAMUEL O. CLARK, JR.,
Assistant Attorney General,
Department of Justice,
Washington, D. C.

SEWALL KEY,
Special Assistant to the Attorney General.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Aug. 25, 1939.

(Appearance of Mr. L. W. Post as Counsel for Petitioner.)

The Clerk will enter my appearance as Counsel for the Petitioner.

L. W. POST,
Sp. Asst. to the A. G.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Dec. 11, 1939.

[fol. 42] (Appearance of Counsel for Respondent.)

The Clerk will enter my appearance as Counsel for the Respondent.

R. C. ALDERSON,
S. D. CATHERWOOD,
218 First National Bank Building,
Austin, Minnesota.

Dated November 9, 1939.

Catherwood, Hughes & Alderson,
Of counsel for Respondent,
Austin, Minnesota.

(Endorsed): Filed in U. S. Circuit Court of Appeals, Nov. 13, 1939.

(Order of Submission.)

March Term, 1940.

Monday, March 11, 1940.

This cause having been called for hearing in its regular order, the same was argued by Mr. L. W. Post, Special Assistant to the Attorney General, for petitioner, and by Mr. R. C. Alderson for respondent.

Thereupon, this cause was submitted to the Court on the transcript of the record from said Board of Tax Appeals and the briefs of counsel filed herein.

[fol. 43] (Opinion.)

United States Circuit Court of Appeals,
Eighth Circuit.

No. 11,565.—March Term, A. D. 1940.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,
vs.
Jay C. Hormel,
Respondent.

On Petition to Review Decision of the United States Board of Tax Appeals.

[April 25, 1940.]

Mr. L. W. Post, Special Assistant to the Attorney General (Mr. Samuel O. Clark, Jr., Assistant Attorney General, and Mr. Sewall Key, Special Assistant to the Attorney General, were with him on the brief) for Petitioner.

Mr. R. C. Alderson (Mr. S. D. Catherwood and Messrs. Catherwood, Hughes & Alderson were with him on the brief) for Respondent.

Before Sanborn, Thomas, and Van Valkenburgh, Circuit Judges.

Sanborn, Circuit Judge, delivered the opinion of the Court.

This is a petition to review a decision of the Board of Tax Appeals (39 B.T.A. 244) determining that there were no deficiencies in income taxes of the respondent for the years 1934 and 1935.

Respondent, a resident of Minnesota, (hereinafter referred to as the taxpayer) on July 16, 1934, created three irrevocable short-term trusts for the benefit of his three minor sons. To himself and another, as trustees of each of the trusts, he conveyed shares of stock of Geo. A. Hormel & Co., of which he was an officer. Each trust instrument recited that the trust was created for the benefit of the taxpayer and the benefit of the taxpayer's wife as guardian of the son named therein. The income of each trust up to $2,000 a year was to be paid to the wife as such guardian "for the use and benefit of" her ward, and the income, if any, in excess of $2,000 a year was to be paid to the taxpayer. Each trust was to terminate at the end of three years or upon the earlier death of either the taxpayer or the son named in the trust instrument. Upon the termination of the trusts, the corpus was to belong to the taxpayer or, in case of his death, to his heirs or the persons named in his will. The trustees had authority to appoint proxies to vote the stock held in trust. The trustees were not liable to the guardian, or to the sons, for loss except in case of wilful violation of duty. No title to the trust estates or to prospective dividends therefrom vested in the guardian, nor were the estates or such dividends subject to her debts or those of her wards. The guardian and her wards were prohibited from selling, encumbering or disposing of any interest in the trust estates or any dividends therefrom prior to the actual receipt of the trust income to which they were entitled from the trustees. In case of sale by the trustees of the stock held in trust and the substitution of other securities therefor, the income therefrom was to be trust income.

In each of the years 1934 and 1935 the taxpayer's personal income exceeded one hundred thousand dollars. In his returns for those years he took credit in his exemptions for his three dependent sons, the beneficiaries of the three trusts. He did not include in his gross income for those years the trust income of the three trusts which was paid to the guardian of the three sons under the terms of the trust instruments. Such income was reported in the

returns of the beneficiaries. The Commissioner, however, included all of the income of these trusts in the taxpayer's gross income and assessed a deficiency accordingly. In his deficiency letter, the Commissioner based his action upon §166 of the Revenue Act of 1934 (26 U.S.C. §166; 48 Stat. 680, 729).[1]

The taxpayer appealed to the Board of Tax Appeals. In the proceedings before the Board, the Commissioner relied upon §166 and §167 of the Revenue Act of 1934.[2] The Board decided that neither of these sections was applicable. A minority of the Board members were of the opinion that under §167 the trust income paid to the guardian of the taxpayer's sons was taxable to the taxpayer because it could have been used for relieving him of his obligation to support his children *(Douglas* v. *Willcuts,* 296 U.S. 1) and because the wife had "no interest adverse to petitioner in the distribution of the income from the children's trusts." The Board entered its order on March 28, 1939, determining that there were no deficiencies in income taxes for the years in question.

In his petition for review of the decision of the Board, the Commissioner assigned as error: (1) the ruling of the Board that the entire income of the three trusts was not taxable to the taxpayer; (2) the failure of the Board to rule that such trust income was taxable to him under either §166

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[1] §166. Revocable Trusts.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor.

[2] §167. Income for Benefit of Grantor.

(a) Where any part of the income of a trust—

* * * * * * *

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;

* * * * * * *

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question.

or §167. The record and briefs were filed in this Court prior to January 1, 1940. In his brief, the Commissioner, under "Specifications of Error to be Urged", stated:

"The Board of Tax Appeals erred:

"1. In holding that the trust income here involved was not includable in the taxpayer's gross income for the years 1934 and 1935.

"2. In not holding that this income was taxable under Sections 166 and/or 167 of the Revenue Act of 1934.

"3. In entering its order of no deficiencies in income tax for the years 1934 and 1935 and in not entering an order that there are deficiencies in the amounts of tax attributable to the trust income here involved."

Under "Points and Authorities", the Commissioner's brief states:

"1. The grantor did not give up sufficient interest in the trust income to avoid taxation under Sections 167 and/or (22a) of the Revenue Act of 1934.[3]

"2. The grantor did not give up sufficient interest in the trust corpus to avoid taxation on income therefrom under Sections 166 and/or 22(a) of the Revenue Act of 1934.

"3. The grantor retained sufficient interest in the income and corpus of the trusts to justify taxing him under Sections 167, 166 and 22(a), considered together and read as a whole."

The taxpayer, in his answering brief, under "Points and Authorities", stated:

"1. Grantor gave up sufficient interest in the trust income to avoid taxation under Sections 167 and/or 22(a) of the Revenue Act of 1934.

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[3] §22. Gross Income.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

"2. The grantor gave up sufficient interest in the trust corpus to avoid taxation on income therefrom under Sections 166 and/or 22(a) of the Revenue Act of 1934.

"3. Grantor did not retain sufficient interest in the income and the corpus of the trust to justify taxing him under Sections 166, 167 and 22(a), considered together and read as a whole."

Under Point 2 the taxpayer cites the case of *Clifford* v. *Helvering*, 8 Cir., 105 F.2d 586, which involved a short-term family trust similar to those here in suit. This Court held in that case that the income from the trust there considered was not taxable to the grantor. Certiorari was granted in that case by the Supreme Court of the United States, and the case was pending in that court at the time briefs in the case at bar were filed in this Court. On February 26, 1940, the Supreme Court filed its decision (*Helvering* v. *Clifford*, ... U.S. .....), reversing this Court and holding that the income from the family trust created by Clifford was sufficiently his income to be taxable to him under §22(a). On the same day the Supreme Court decided *Helvering* v. *Wood*, ... U.S. ....., in which the Circuit Court of Appeals of the Second Circuit had held (104 F.2d 1013) that income from a short-term family trust was not taxable to the grantor. The Supreme Court affirmed on the ground that the Commissioner in the proceedings before the Board had relied solely on §166 and §167 and in the Court of Appeals had expressly waived reliance upon any section other than §166.[4]

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[4]The Supreme Court said:

"For a wholly different reason, petitioner's argument based on §22(a) must fail. The Board of Tax Appeals purported to place its decision solely on §166 and §167 of the Act. Petitioner in his assignments of error specifically mentioned only §166 and §167, not §22(a). In his brief before the Circuit Court of Appeals petitioner expressly waived reliance upon any section other than §166. Though petitioner in his petition for certiorari relied on §22(a), respondent in opposition thereto took the position that that point was not available to petitioner here as it was not raised below. In view of these facts, especially the express waiver below, we do not think that petitioner should be allowed to add here for the first time another string to his bow. As we have indicated, the issues under §166 and §22(a) are not coterminous. Though both deal with concepts of ownership, the range of inquiry under the latter is broad, under the former confined. To open here for the first time and in face of the express disclaimer an inquiry into the broader field is not only to deprive this Court of the assistance of a decision below but to permit a shift to ground which the taxpayer had every reason to think was abandoned in the earlier stages of this litigation. See *Burnet* v. *Commonwealth Improvement Co.*, 287 U.S. 415, 418. It is not apparent why a less strict rule is necessary in order adequately to protect the revenue." (*Helvering* v. *Wood*, ... U.S. ....., ...)

After these decisions of the Supreme Court, the taxpayer filed in this Court a supplemental brief, asserting that, since the Commissioner had not contended before the Board that under §22(a) the trust income from the three trusts in suit was taxable to the taxpayer, and had not expressly mentioned that section in his assignments of error in petitioning for a review or expressly referred to it in his specifications of error in his brief in this Court, the question of the applicability of §166 and §167 was all that was before this Court for review. The Commissioner then filed an answering brief abandoning the contention that §166 was applicable, and asserting that the income from the trusts was for purposes of taxation the income of the taxpayer under §22(a) and §167, and that this Court was not precluded from considering the applicability of §22(a).

It is our opinion that the Board was right in deciding that §167 was not applicable to these trusts. We have no reason to suppose that the laws of Minnesota governing these trusts and the guardianship of the Hormel children would have permitted the guardian to expend for their support trust funds received by her for their use and benefit, since their father was abundantly able to support them. There is no basis for believing that the trusts were created for the purpose of relieving the taxpayer of the obligation of supporting his children or that the trust income belonging to them was or could have been so used. There is no presumption that gifts in trust such as these are in discharge of any obligation for support. *Shanley* v. *Bowers*, 2 Cir., 81 F.2d 13, 15. Moreover, the wife of the taxpayer, as guardian of the minor children, would be strictly accountable to such children for their share of the trust income, and, for that reason, she as guardian had a substantial adverse interest to the taxpayer in the distribution thereof.

The decision of the Board, however, cannot be sustained, in view of *Helvering* v. *Clifford, supra*, if we are at liberty to consider §22(a). There are, we think, no controlling distinctions between the short-term family trusts here in

suit and the trust which was involved in that case. The question of the right of this Court to reverse the Board, which decided correctly the only questions expressly presented to it, is not free from doubt.

The general rule is that a question of law not presented or passed upon below cannot be raised on appeal. *Virtue* v. *Creamery Package Mfg. Co.*, 227 U.S. 8, 38-39; *Duignan* v. *United States*, 274 U.S. 195, 200. This rule is applicable to review of decisions of the Board of Tax Appeals. *Kottemann* v. *Commissioner*, 9 Cir., 81 F.2d 621, 623; *National Contracting Co.* v. *Commissioner*, 8 Cir., 105 F.2d 488, 494. "It is only in exceptional cases, and then only in cases from the federal courts, that questions not pressed or passed upon below are considered here. *Duignan* v. *United States*, 274 U.S. 195." *Blair* v. *Oesterlein Co.*, 275 U.S. 220, 225. An apparent exception to the rule is, that if the decision below is correct it must be affirmed although the lower court relied upon a wrong ground or gave a wrong reason (*Helvering* v. *Gowran*, 302 U.S. 238, 245), and this applies to the review of decisions of the Board of Tax Appeals. *Helvering* v. *Rankin*, 295 U.S. 123, 132-133; *Helvering* v. *Gowran*, *supra*, p. 246. In exceptional cases there may be a reversal by a reviewing court of a decision for reasons not pressed or passed upon below. *Trapp* v. *Metropolitan Life Ins. Co.*, 8 Cir., 70 F.2d 976, affirmed on rehearing 72 F.2d 374, certiorari denied 293 U.S. 596.

In the *Trapp case* the situation was in substance this: A beneficiary brought suit upon a policy of life insurance which the company asserted had lapsed. The question turned upon the construction of certain Missouri statutes. The statutes which the plaintiff expressly relied upon did not sustain her contention that the policy was in force at the time of the insured's death. She did not rely upon §5741 of the Missouri Statutes, because the construction which had been given to that section by the courts of Missouri up to the time of trial made it inapplicable. The District Court properly directed a verdict for the defendant, upon which judgment was entered. The plaintiff appealed

and before the case was presented to this Court the Supreme Court of Missouri construed §5741 in such a way as to make it obvious that the policy in suit was in full force at the time of the insured's death, and that the company actually was indebted to the plaintiff for the face of the policy. After a consideration of the rule now relied upon by the taxpayer for an affirmance, we said (page 982 of 70 F.2d):

"The record made in the court below contains all of the facts essential to a correct determination of this controversy. The instruction of a verdict favorable to the defendant is assigned as error, and section 5741 of the Missouri Statutes, as interpreted by the case of *Gooch* v. *Metropolitan Life Ins. Co., supra.* (Mo. Sup.) 61 S.W.2d 704, is urged upon us as a ground for reversal.

"We regard this case as an exceptional one and analogous to those in which a change of the law after trial has required a reversal of a judgment right when rendered. We have no intention of departing from the general rule that this court will not review questions not presented to nor passed upon by the lower court, but we think it is our duty to recognize the changed situation and 'to give effect to a matter arising since its judgment and bearing directly upon the right disposition of the case.' *Gulf, Colorado & Santa Fe Ry. Co.* v. *Dennis, supra,* 224 U.S. 503, 507, 32 S. Ct. 542, 543, 56 L. Ed. 860."

In this case there is no dispute about the facts. The question of the taxability to the taxpayer of the income of these trusts was in a broad sense before the Board. In its opinion it referred to rulings to the effect that the income of trusts under which there was reserved to the grantor practically all of the substantial benefits as owner were taxable to him.[5] The Board could not, of course, have

[5]The Board in the closing paragraph of its decision sa

"Cases have been presented to the Board involving trusts created for short periods where the grantor has reserved to himself practically all of the substantial benefits as owner of the property, and the Board has held that such trusts are lacking in substance to such an extent that the income is taxable to the grantor. See *Estate of A. C. O'Laughlin,* 38 B.T.A. 1120, and cases there cited. The respondent does not argue that those cases are applicable here and obviously they are not, because here the trusts were not lacking in substance during the three years of their existence."

been expected to anticipate the decision of the Supreme Court in *Helvering* v. *Clifford, supra.* But, because of that decision, we are now advised that the Commissioner was right in determining a deficiency, although the reason given by him for his determination was wrong. We regard the decision of the Supreme Court—rendered after the filing of the opinion and order of the Board—as a matter bearing directly upon the right disposition of this case, and as having created a changed situation which it is our duty to recognize.

The decision of the Board is reversed upon the authority of *Helvering* v. *Clifford, supra.*

[fol. 53] (Decree.)

United States Circuit Court of Appeals,
Eighth Circuit.

March Term, 1940.

Thursday, April 25, 1940.

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,
No. 11565. vs.
Jay C. Hormel.

On Petition to Review Decision of United States Board of Tax Appeals.

This cause came on to be heard on a petition to review a decision of the United States Board of Tax Appeals (39 B. T. A. 244) determining that there were no deficiencies in income taxes of the respondent for the years 1934 and 1935, and was argued by counsel.

On Consideration Whereof, and upon the authority of Helvering vs. Clifford, ... U. S. ....., Opinion filed February 26, 1940, It is now here ordered and adjudged by this Court that the decision of the said Board of Tax Appeals in this cause, be, and the same is hereby, reversed, without the taxation of costs in favor of either of the parties in this Court.

And it is further ordered by this Court that this cause, be, and the same is hereby, remanded to the said Board of Tax Appeals for proceedings not inconsistent with the opinion of this Court.

April 25, 1940.

[fol. 54] (Clerk's Certificate.)

United States Circuit Court of Appeals,
Eighth Circuit.

I, E. E. Koch, Clerk of the United States Circuit Court of Appeals for the Eighth Circuit, do hereby certify that the foregoing contains the record on petition to review the decision of the United States Board of Tax Appeals as prepared and printed under the rules of the United States Circuit Court of Appeals for the Eighth Circuit, under the supervision of its Clerk, and full, true and complete copies of all the pleadings, record entries and proceedings including the opinion, had and filed in the United States Circuit Court of Appeals, except the full captions, titles and endorsements omitted in pursuance of the rules of the Supreme Court of the United States, in a certain cause in said Circuit Court of Appeals wherein Guy T. Helvering, Commissioner of Internal Revenue, was Petitioner, and Jay C. Hormel was Respondent, No. 11565, as full, true and complete as the originals of the same remain on file and of record in my office.

I do further certify that on the thirteenth day of May, A. D. 1940, a mandate was issued out of said Circuit Court of Appeals in said cause, directed to the United States Board of Tax Appeals.

In Testimony Whereof, I hereunto subscribe my name and affix the seal of the United States Circuit Court of Appeals for the Eighth Circuit, at office in the City of St. Louis, Missouri, this eighteenth day of June, A. D. 1940.

E. E. KOCH,
Clerk of the United States Circuit Court of Appeals for the Eighth Circuit.

(Seal)

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[fol. 55] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 14, 1940

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit is granted.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(2297)

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1940

No. 257

JAY C. HORMEL,

Petitioner,

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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No. 257

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

To the Honorable Charles Evans Hughes, Chief Justice of the United States, and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully shows:

I.

Statement of Matters Involved.

This case involves the legality of including income of three irrevocable trusts created by petitioner in 1934, under Section 22 (a) of the Revenue Act of 1934, in petitioner's income for federal income tax purposes.

II.

Jurisdiction.

The judgment (decree) of the Circuit Court of Appeals for the Eighth Circuit was entered April 25, 1940 (R. 50-51). The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code as amended by the act of February 13, 1925.

III.

Questions Presented.

The petitioner, in 1934, declared himself and another, co-trustees of certain property to pay the net income therefrom to Germaine D. Hormel as guardian of a minor son of petitioner, the trust to terminate at the expiration of three years or upon the earlier death of taxpayer or the minor child named, whereupon the corpus was to be restored to the grantor or his estate. There were created three trusts, one for each child, each alike in amount and terms. The question is: Was the net income of the trusts for the years of 1934 and 1935 properly included in the taxpayer's gross income?

IV.

Statute and Regulations Involved.

The statute and regulations involved will be found in the appendix, *infra*, page 24.

V.

Summary Statement of the Facts Involved.

Petitioner, a resident of Minnesota (hereinafter referred to as the taxpayer), created three irrevocable trusts on July 16, 1934 (R. 30-37), for the benefit of his three minor sons. He named himself and another who accepted said

trust (as co-trustees) and conveyed stock of Geo. A. Hormel & Company to said co-trustees. It was provided therein that the co-trustees should receive and hold said securities and collect dividends in trust for Germaine D. Hormel as guardian of the named sons (R. 30). The dividends of each trust up to $2,000.00 a year shall be paid to the guardian "for the use and benefit of" her ward and the excess, if any, to be paid to taxpayer. The co-trustees have power to appoint proxies to vote the stock held in trust and to exercise voting powers (R. 30). Upon the termination of the trust, the corpus or principal was to belong to taxpayer, or in case of his death, to his heirs or persons named in his will. The co-trustees were not liable except for willful or deliberate violation of duties. No title or income vested in the guardian or minor ward and no principal or income was chargeable for their debts (R. 31). They were prohibited from selling or encumbering any interest in the trust estate or any dividends therefrom prior to actual receipt. The trust terminates at the end of three years from date or upon the earlier death of taxpayer or son named in the trust. At no time before the termination date, the taxpayer or co-trustees have the power to revest in taxpayer any part of the corpus or income other than therein provided (R. 31). It should be noted in passing that under the terms of the trusts, the co-trustees had no power to sell, no power to reinvest, no power to compromise, no power to hold property in their own individual names, and that all the powers mentioned therein were in the co-trustees.

In the years of 1934 and 1935, all income of the trusts was paid to Germaine D. Hormel as guardian in accordance with the terms and were included in her returns as such (R. 29). Taxpayer had substantial income during said years and did not include said trust income from the three trusts which was paid to the guardian (R. 11). The re-

spondent (hereinafter referred to as the Commissioner) included said dividends in petitioner's gross income and assessed a deficiency, basing his action solely upon paragraph 166 of the Revenue Act of 1934 (26 U. S. C., paragraph 166, 48 Stat. (680, 729), (R. 10). Taxpayer appealed to the Board of Tax Appeals and in proceedings before the Board a stipulation was entered into, containing, among other things, a statement as follows: "For income tax purposes the sole question involved for the Board to decide is whether any or all the items of income set forth in paragraph 7 of this stipulation are taxable to petitioner as determined by the respondent" (R. 29). The Commissioner, in the hearing before the Board, relied solely upon Sections 166 and 167 of the Revenue Act of 1934 (R. 44). The Board entered an order on March 28, 1939, determining that neither of the sections were applicable and determining that there was no deficiency (R. 13-22). Commissioner, in his petition for review to the Circuit Court of Appeals, assigned as error: (1) The ruling of the Board that the income of the three trusts was not taxable to the grantor; and (2) failure of the Board to hold that income was taxable to taxpayer under either 166 or 167 (R. 25). In his subsequent brief in support of the petition, the Commissioner, under Points and Authorities, argued that the taxpayer did not give up sufficient interest in the trust income or the trust corpus to avoid taxation under Sections 166, 167 and/or 22 (a) of the Revenue Act of 1934, and further that the taxpayer retained sufficient interest in the income and corpus to justify taxing him under Sections 166, 167 and/or 22 (a), considered together and read as a whole (R. 45). Taxpayer, in his supplemental brief, asserted that since Commissioner had not contended before the Board that under 22 (a), the trust income from the three trusts in suit was taxable to taxpayer and had not expressly men-

tioned that section in his assignments of error in petitioning for review nor referred to it in his specification of errors in the brief in the Court, the only matters before the Court for review were Sections 166 and 167 (R. 47). Commissioner, in answering brief, abandoned his contention that 166 was applicable and asserted that the income from the trusts was, for purposes of taxation, the income of taxpayer under 22 (a) and 167 (R. 47), and that the Court was not precluded from considering the applicability of 22 (a). The Circuit Court of Appeals found that the Board was right in deciding that Paragraph 167 was not applicable to the trusts (R. 47). The Court found, however, on authority of *Helvering* v. *Clifford* (it was decided on Section 22 (a)) that the income of the trusts was income of the taxpayer and the decision of the Board was reversed upon authority of *Helvering* v. *Clifford* (R. 50) stating, however, "that the question of the right of this Court to reverse the Board, which decided correctly the only questions expressly presented to it, is not free from doubt" (R. 48).

VI.

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1. In not limiting the issues in the case before the Circuit Court to the questions presented to the Board of Tax Appeals.

2. In reversing the Board of Tax Appeals which decided correctly the only questions expressly presented to it.

3. In allowing questions of law not presented or passed upon before the Board, to be raised. (In particular, allowing the consideration of Section 22 (a) of the Revenue Act of 1934.)

4. In holding the trust income here involved was taxable to petitioner under Section 22 (a) of the Revenue Act of 1934.

5. In holding that the trust income here involved was taxable to petitioner under the decision of *Helvering* v. *Clifford,* 309 U. S. 331, 60 S. Ct. 554.

6. In holding that there were no controlling distinctions between the short term family trusts here and the trust involved in the case of *Helvering* v. *Clifford, supra.*

7. In holding "the question of the taxability to the taxpayer of the income of these trusts was, in a broad sense, before the Board".

8. In holding the Commissioner was right in determining a deficiency although the reason given by him was wrong.

9. In holding taxpayer taxable on the income here involved under Section 22 (a) of the Revenue Act of 1934, in that said section, or any other section, taxing the income of the trusts here to petitioner would be such power of taxation that its constitutionality would be doubtful, being in violation of the due process clause of the United States Constitution, Article of Amendment No. V (U. S. C. A. Constitution, Part 1, page 39).

10. In reversing the decision of the Board of Tax Appeals.

VII.

Reasons Relied on for the Allowance of the Writ.

1. The decision of said Circuit Court of Appeals reversing the Board of Tax Appeals, which correctly decided the only questions expressly presented to it, is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit on the same matter in the case of *Helvering* v. *Achelis,* decided June 24, 1940.

2. The decision of said Circuit Court of Appeals as to the right of the Circuit Court to reverse the Board of Tax Appeals upon a point not raised before it, is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit, on the same matter in the case of *Helvering* v. *Achelis,* decided June 24, 1940, Calendar No. 28, Docket No. 16598, and is further in conflict with the case of *Rhodes* v. *Commissioner* in the United States Circuit Court of Appeals, Fourth Circuit, 111 F. (2d) page 53.

3. The decision of said Circuit Court of Appeals granting an appellant the right to raise an issue for the first time in an appellate court for the purpose of reversing an adverse decision is in conflict with the decision of the Circuit Court of Appeals for the Fourth Circuit in a similar matter in the case of *Rhodes* v. *Commissioner,* 111 F. (2d) 53.

4. The decision of the Circuit Court of Appeals granting an appellant the right to raise an issue for the first time in an appellate court for the purpose of reversing an adverse decision and in reversing the Board of Tax Appeals, which has already decided correctly the only questions expressly presented to it, and reversing the Board of Tax Appeals upon a point not raised before it, is in conflict with the decisions of the United States Supreme Court on the same or similar matters in the case of *Helvering* v. *Wood,* 309 U. S. 344, 60 S. Ct. 551; and *General Utilities Co.* v. *Helvering,* 296 U. S. 200, 206.

5. The decision of the Circuit Court of Appeals to the effect that the taxpayer here reserved all, or practically all, of the substantial benefits by holding taxpayer liable thereon; is a decision of a Federal question in a way probably in conflict with applicable decisions of this Court.

6. The Circuit Court of Appeals, in deciding that petitioner is taxable on income of the trusts created by him and

distributed to the beneficiaries, has decided that, although property has been irrevocably assigned to the trustee and the assignor has irrevocably relinquished the right to demand the income thereof and control after its receipt, and that the assignor is taxable on the income arising after said transfer and has thus rendered a decision in conflict with the decisions of other Circuit Court of Appeals on the same matter, and in conflict with applicable decisions of this Court.

7. If it be held that petitioner reserved practically all of the substantial benefits as owner under said Section 22 (a), then the question is raised as to the constitutionality of said Section 22 (a) in that it is doubtful if said Section 22 (a) is constitutional to that extent under the rule of *Hoeper* v. *Tax Commission of Wisconsin*, 284 U. S. 206.

WHEREFORE, Your petitioner prays that a writ of certiorari issue under the seal of this Court, directed to the Circuit Court of Appeals for the Eighth Circuit, commanding said Court to certify and send to this Court a full and complete transcript of the record and of the proceedings of said Circuit Court had in the case numbered and entitled on its Docket No. 11565, Guy T. Helvering, Commissioner of Internal Revenue, Petitioner, *v.* Jay C. Hormel, Respondent, to the end that this cause may be reviewed and determined by this Court as provided by the statutes of the United States and that the judgment herein of said Circuit Court be reversed by the Court, and for such further relief as to this Court may seem proper.

Dated July 17, 1940.

JAY C. HORMEL,
By R. C. ALDERSON,
Counsel for Petitioner.

Of Counsel:
S. D. CATHERWOOD,
CATHERWOOD, HUGHES & ALDERSON.

Addenda.

We wish further at this time to call the court's attention to the fact that we wish to cite the case of *Commissioner* v. *Richter,* decided July 17, 1940, in the Third Circuit Court of Appeals, No. 7418, in support of the first four reasons relied on for the allowance of the writ, said reasons being set forth at pages 6 and 7 of the petition.

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No. 257

JAY C. HORMEL,

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GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 13-22) is reported in 39 B. T. A. 244. The opinion of the Circuit Court of Appeals (R. 42-50) is reported in 111 F. (2d) 1.

II.

Jurisdiction.

See petition for certiorari above, page 2.

III.

Specification of Errors.

See petition for certiorari above, page 5.

IV.

Summary of Argument.

Petitioner contends:

(a) The Circuit Court was without authority to reverse the Board, which decided correctly the only questions of law presented to it and was without authority to consider questions of law not presented or passed upon below and not set forth in assignments of error in the petition for review. It was without authority to consider Section 22 (a) of the Revenue Act of 1934 or any other provisions than the provisions 166 and/or 167 of the Revenue Act of 1934, as set forth in the petition for review before the Circuit Court of Appeals.

(b) That in any case, neither 22 (a) nor any other provision of the 1934 Revenue Act justifies the tax of the income herein mentioned to the petitioner under the rule of *Helvering* v. *Clifford* or otherwise.

(c) In event taxpayer is held to be subject to taxation under Section 22 (a), such a finding would be an unconstitutional construction to place on the law, it being in violation of due process to tax income to taxpayer he may not receive.

V.

ARGUMENT.

POINT I.

The Circuit Court was without authority to consider Section 22 (a) of the Revenue Act of 1934 and to reverse the Board thereon.

At no stage in the proceeding prior to his brief in the Circuit Court in support of his petition for review did the Commissioner take any position to the effect that the income was taxable to respondent under any provision of the Revenue Act of 1934, other than Section 166 or 167. In his notice of deficiency, Commissioner stated that the dividends or the income that he proposed to tax as income of taxpayer were to be taxed for the reason that, citing Section 166:

> "In view of the above, it is the opinion of this office that, since you, the grantor, may revest title to the corpus of the trusts in yourself if you survive your wife, and at the end of three years with respect to the trusts for the three sons, they are revocable trusts under section 166 of the Revenue Act of 1934 and article 166-1 of Regulations 86 as amended by Treasury Decision 4629, and the income therefrom is taxable to you" (R. 10).

and further stated:

> "* * * the Revenue Act contemplates taxing the income to the grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period" (R. 8).

Section 166 is the section dealing with taxation of income from revocable trusts. Before the Board of Tax Appeals, Commissioner relied solely upon Sections 166 and 167, and

the Board based its decision on Sections 166 and 167 (R. 13 and 20-22). Commissioner in his petition for review of the decision of the Board of Tax Appeals, based his assignments of error solely on the grounds of Sections 166 and 167 (R. 25). For the first time does he inject a new point, contending taxpayer is subject to tax under 22. (a) in his brief in support of the petition for review to the Circuit Court (R. 45). Taxpayer, by supplemental brief, contended that since Commissioner had not contended before the Board for the taxation of the trust income under 22 (a) and had not expressly mentioned that section in his assignments of error in petitioning for a review, or expressly referred to it in his specification of errors in the brief in the court, the court was limited to the questions of the taxability of said income under 166 and 167 as that was the question that was before the court for review (R. 47). The Circuit Court found adversely to the taxpayer. This Court does not favor injection of a new point at this stage of litigation. *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481; *Helvering* v. *Minnesota Tea Co.*, 296 U. S. 378; *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206; *Helvering* v. *Wood*, 309 U. S. 344. The Circuit Court held:

> "The decision of the Board, however, cannot be sustained, in view of *Helvering* v. *Clifford, supra,* if we are at liberty to consider ¶ 22 (a). There are, we think, no controlling distinctions between the short-term family trusts here in suit and the trust which was involved in that case. The question of the right of this Court to reverse the Board, which decided correctly the only questions expressly presented to it, is not free from doubt" (R. 47).

It is very evident that the court did not feel clear on this matter, especially in view of their statement that it "is not free from doubt". This being especially true where the Board decided correctly the *only questions* expressly presented to it. This decision is directly in conflict with the

more recent decision of *Helvering* v. *Achelis,* Circuit Court of Appeals, Second Circuit, decided June 24, 1940 (no record), which decision involved taxability of income of a short term trust and where the Commissioner taxed the income under Section 166 and the Board expunged the deficiency and the Commissioner appealed to the court. The court held, refusing to consider Section 22 (a), and citing *Helvering* v. *Wood,* 309 U. S. 344; *General Utilities & Operating Co.* v. *Helvering,* 296 U. S. 206; *Helvering* v. *Salvage,* 297 U. S. 106, 109; *Rhodes* v. *Commissioner,* 111 F. (2d) 53: "Until otherwise advised, we shall assume they are right and that the point relied upon is not before us." In the case of *Rhodes* v. *Commissioner,* 111 F. (2d) 53, the question of the status of an issue raised for the first time before an appellate court was brought up, and the court stated, citing *General Utilities* v. *Helvering, supra; Helvering* v. *Salvage, supra;* and *Helvering* v. *Wood, supra:* "The authorities cited above seem clearly and positively to enunciate the rule that an appellant may not raise an issue for the first time in an appellate court for the purpose of reversing an adverse decision of the Board of Tax Appeals."

In further support of the contention that Commissioner was limited in pressing his claim before the Circuit Court of Appeals, to Sections 166 and 167, we call the Court's special attention to the stipulation (R. 29), which provided that: "For income tax purposes the sole question involved for the Board to decide is whether any or all the items of income set forth in paragraph 7 of this stipulation are taxable to petitioner as determined by the respondent." (Respondent was Commissioner before the Board.) It is the contention of the taxpayer here that the phrase "as determined by the respondent", taken in conjunction with the remainder of the paragraph, meant "in the same or like manner heretofore decided by the Commissioner". We

refer to *Hoeper* v. *Wells, Fargo & Co.*, 27 Cal. 11, 30, 85 Am. Dec. 211, where it is stated:

> "The word 'as' is defined in the last edition of Webster's Dictionary as follows: 'Like; similar to; of the same kind; in the same manner; in the manner in which.' This is obviously the ordinary import of the word in a bill of lading restricting the carrier's liability 'except as forwarder.' The carrier's liability was to be 'similar to that of forwarders,' or 'of the same kind.' They were liable in the same manner, or in the manner in which forwarders are liable."

There are innumerable decisions which define the word "as" as meaning "in the same or like manner" and quotations may be found in *Words and Phrases, Permanent Edition, Vol. 4, page 288.* The word "determined" has been defined in Webster's Dictionary as "decided" and indicates (heretofore decided) as put in the stipulation here and the basis upon which this case was tried entirely, as the Commissioner had heretofore decided it; otherwise it could not mean anything, if the Commissioner could constantly, from day to day, change his position and opinion, taxpayer would never know what issue he would be called upon to meet. The phrase "as provided by the laws" has been held to refer to laws already in existence, unless intention is expressed otherwise in the instrument. *In re Wilson's Estate,* 225 Pacific 283, 65 Cal. Appeals 680.

Surely, in view of the stipulation, any facts before the court could only be considered in the light of the Commissioner's deficiency notice (R. 5-12) and could not be generally held to be before the Board in a broad sense as set forth in the Circuit Court's decision (R. 49).

There are numerous fact questions that might be brought up for consideration under 22 (a) and it surely could not be held here that there should be a reversal under any rule to the effect that in exceptional cases there may be a re-

versal by review in court of a decision upon a point or question not pressed or passed upon below, especially in view of the more recent decision of *Helvering* v. *Wood*, 309 U. S. 344, 60 S. Ct. 551. We submit that this question clearly calls for a review here, in view of the statement of the Circuit Court of Appeals to the effect that it is not free from doubt: "The question of the right of this Court to reverse the Board, which decided correctly the only questions expressly presented to it, is not free from doubt" (R. 48).

Point II.

In event the above point should be decided adversely, no provision of the Revenue Act of 1934 justifies a tax on the income here before the court under 22 (a) or otherwise.

As we have set forth in the point above, we contend that this case does not involve the questions of taxability of income of these trusts under 22 (a). However, if it could be considered, we believe Commissioner's application here would fail. It seems very clear that here there is a misapplication of the rule set forth in *Helvering* v. *Clifford*, 309 U. S. 331, as there are many distinguishing features between the case here before the court and *Helvering* v. *Clifford*, *supra*.

The courts have recognized under a general concept of income that the grantor may be the owner in substance of the income of a trust by virtue of his unfettered command of the corpus or income and the use of the income by the grantor to satisfy his legal obligations. At no point before the Board of Tax Appeals was this contended for, as is shown by the findings of the Board (R. 16 and R. 18), nor did the Commissioner at any time before the Board press the fact that the trusts were lacking in substance (R. 18). Here the grantor and another were co-trustees. The general rule applicable to trustees is not the same as in the case

of executors. They are not usually concerned with the administration of the estate of the deceased. They must act jointly in dealing with the trust estate. In the case of a private trust, as distinguished from a public or charitable trust, where there are several trustees and all have accepted or are exercising the office, their powers, interest and authority are equal and undivided. They cannot act separately, but must act as a unit, except where authorization to act is given to a majority of trustees by statute or by the instrument creating the trust, or except possibly in the case of an urgent emergency. It is generally held that where trustees cannot agree, the court has no power to interfere and direct voting. This would limit power and command of the grantor. See *Scott on Trusts,* paragraph 193.1:

> "Where there are several trustees they must all join in voting the stock or in giving a proxy to one of their number or to a third person. If the trustees do not concur in voting, the shares cannot be voted." 107 Mscl. 443—177 N. Y. S. 757, 256 N. Y. S. 495.

Paragraph 194:

> "Where there are two or more trustees, it is essential that they all concur in the exercise of the powers conferred upon them."

See *Winslow* v. *Baltimore,* 23 S. Ct. 443, 188 U. S. 646, which requires signatures of all trustees, and also *Morville, Jr.* v. *Fowle,* 10 N. E. 766, 768 (Mass.). See *Perry on Trusts and Trustees,* 7th Edition, paragraphs 411 and 412.

In each of the acts hereinafter covered, it is apparent that it would require joint action by the co-trustees and in event one of the trustees refuses to act, the only way that the other can act is on application to the court. See *American Law Institute on Trusts,* paragraph 194:

> "If there are two or more trustees, action by all of them is necessary to the exercise of the powers con-

ferred upon them as trustees. If one of them refuses to concur in the exercise of a power, the others cannot exercise the power. In such a case, however, if it appears to be for the best interest of the trust that there should be an exercise of the power, the court may on application of a co-trustee or beneficiary direct its exercise."

Both the *Clifford* and the instant case provided for the trustees voting the shares of stock, but here both trustees must vote. The trust in the *Clifford* case authorized the sale, exchange, mortgage, or pledge on such terms and considerations in the absolute discretion of the grantor of the trust. No such powers were granted in the *Hormel* case, which was a further limit of command.

In the case here before the court, stock described in the trust was transferred to the co-trustees. It is a general rule that where certain property is conveyed to the trustees, such property shall not be sold, but be retained in specie. See *American Law Institute on Trusts,* paragraph 190 (e), page 505:

"The specific mention of certain property in the will or other instrument by which the trust is declared, particularly where such property comprises the whole of the trust property, is an indication of an intention that the property should not be sold but should be retained in specie. This is true even though the particular property is unproductive."

This rule is subject to the restriction that the court will direct or permit the trustees to deviate. *American Law Institute on Trusts,* paragraph 167. It should be noted here that the trust provided:

"He hereby agrees that said co-trustees shall receive and hold said securities and collect the dividends therefrom as a trust estate in trust for Germaine D. Hormel, as guardian of Thomas D. Hormel, and Jay C. Hormel,

as sole beneficiaries, upon the terms and conditions following:'' (R. 32-33).

Here the power of trustees was to ''receive and hold'' and ''pay out income'' (R. 32-33) and would have no further power. See *Duncan* v. *Jaudon,* 15 Wall. 165-177, U. S. Sup. Ct. Reports, Book 21, L. C. P. 142. See also, *Bremer* v. *Hadley et al.,* 81 N. E. 961, and *Geyser-Marion Gold-Min. Co.* v. *Stark,* C. C. A. Eighth Circuit, 106 Fed. 558. The power of the co-trustees here to sell would be subject to court order. The *Clifford* case further provided the trustees had power to invest and reinvest without restriction. No such powers were in the *Hormel* case. The *Clifford* case authorized power of compromise. No such power is in the *Hormel* case. The *Clifford* case authorized the holding of stock in the trustee's name as an individual. No such power is in the *Hormel* case. The *Clifford* case authorized accumulation of income. The *Hormel* case required the payment to the beneficiary of the income on receipt (R. 33). In *Mertz* v. *Guaranty Trust,* 247 U. S. 137, 159 N. E. 888, a case involving a trust made ''to hold the shares and pay the dividends'' to his daughter, the trustee was without authority to invest in shares of a business corporation or even to continue such an investment made by another unless authority to do so was conferred by the creator of the trust, and that the trust conferred authority and imposed a duty to continue the investment in the shares of a specific corporation, which is similar to the *Hormel* case.

In *Hood* v. *Cannon* (S. C.) 182 S. E. 306, in a case involving the recovery of an assessment on a stock from the trustee, the trust provided: ''To hold the said estate and pay over the said income as herein directed.'' The court stated: ''The will of J. H. Sloan, as has already been stated, did not contain any provision which would authorize a change of investment, but, on the contrary, merely provided that the

trustee should hold the estate and pay over the income to the beneficiaries."

It has been held that where no power is given to the trustee to change the investment, it is supposed to be clear that if the trustee disposed of stock and invested the money in other securities, the trustee would be decreed to replace the stock. *Johns* v. *Herbert,* (1894) 2 Court of Appeals, District of Columbia, 485. The courts do not approve change in investments unless express power is given in the instrument. *Perry on Trusts and Trustees,* 7th Edition, paragraph 459:

> "The Courts do not approve of changes in investments, unless express power is given in the instrument of trust; as where a testator gave certain stocks in trust without direction to vary the security, and the trustee disposed of the stocks and invested the money in other security, he ws ordered to replace the entire sum in the same stocks, although the number of shares were increased by the change."

As to the intimacy of the family's relationship and the retained substance of full enjoyment of rights, there is a marked difference in the *Hormel* and the *Clifford* cases. The income in the *Clifford* case was subject to disposition by Mrs. Clifford. In the *Hormel* case, the income of a minor child can only be used by the guardian as deemed reasonable by the Court. *Section* 8935, *Mason's Minnesota Statutes,* 1927, *Vol.* 2 *page* 1761:

> "Whenever a minor child of a living parent has property sufficient for his maintenance and education in a manner more expensive than such parent can reasonably afford, under all the circumstances, the expenses of the education and maintenance of such minor may be defrayed out of his own property, in whole or in part, as shall be deemed reasonable by the court."

which was amended March 29, 1935, by Laws of 1935 Minn., Chap. 72, paragraph 135, effective July 1, 1935:

> "Guardian's Duties.—A guardian shall be subject to the control and direction of the court at all times and in all things. A general guardian of the person shall have charge of the person of the ward. A general guardian of the estate shall (1) pay the reasonable charges for the support, maintenance, and education of the ward in a manner suitable to his station in life and the value of his estate; but nothing herein contained shall release parents from obligations imposed by law for the support, maintenance, and education of their children."

Surely, the wife and this husband must both be unable to support minor before income could be used and here both had substantial incomes (R. 11 and 15). In event the income was disposed of, the guardian would be accountable to such minor child. From the opinion in the *Clifford* case, it will be seen that there the Court found that there was not substantial change in control. The control over the investment remained and control over the income remained, and that, since the income was in the wife, the husband had assurance that the trust would not in any way substantially change his economic position, and that where the benefits flow to him through the wife, added to the legal rights, he retained, the aggregate may be said to be equivalent to what he previously had. None of those rights of control or income were in the grantor here before the Court. To find here that this income is subject to tax would be in effect to find that a trust could not be created for accumulation for the benefit of a minor child and paid to him at some future time upon his maturity, which has been generally accepted and recognized. See *Boeing* v. *Commissioner,* 37 B. T. A. 178, acquiesced in by the Commissioner,

June 26, 1939; and *John Edward Rovensky* v. *Commissioner*, 37 B. T. A. 702.

In general, it has been held that control by the grantor over the subject matter of taxation and benefits of the subject matter of income taxation, are necessary to impose a tax. See *The Taxable Status of Term Trusts* in *Taxes—The Tax Magazine*, for December, 1939, page 710:

> "Congress and the Courts have set forth as the fundamental concepts 'control' by the grantor over the subject matter of taxation, and 'benefits' of the subject matter of income taxation. In the application of the general rule that a trust may be without substance, the Court has applied the fundamental concepts of 'control' and 'benefit' in reaching its determination. The theory of ownership in substance of the corpus of a trust, it would seem, has no standing unless it rests firmly upon either or both of two fundamental concepts of the subjects of income taxation. There must be something equivalent to ownership,—there must be a privilege or benefit in order to impose the burden."

Point III.

In event taxpayer is held to be subject to taxation under Section 22 (a), such a finding would be unconstitutional construction to place on the law.

Taxpayer submits that in view of the showing heretofore, the income from the trusts cannot possibly accrue to his benefit or be turned to him and that a tax law so broad as to tax him upon the income of another would be depriving him of his property without due process of law and without just compensation. *Harvard Law Review*, June, 1940, page 1341:

> "Moreover, constitutional difficulties may arise, since grantor may assert that taxing him on income which is being distributed to some one else, or which he himself may not receive for a long time, or, indeed, may never

> receive, is taxing him upon the income of another and this constitutes a violation of the due process clause."

Hoeper v. *Tax Commission of Wisconsin,* 284 U. S. 206; *Schlesinger* v. *Wisconsin,* 270 U. S. 230. In the *Hoeper* case, on page 215, the court quoted from another Supreme Court case, *Knowlton* v. *Moore,* 174 U. S. 41, regarding powers of Congress:

> "It may be doubted by some, aside from express constitutional restrictions, whether the taxation by Congress of the property of one person, accompanied with an arbitrary provision that the rate of tax shall be fixed with reference to the sum of the property of another, thus bringing about the profound inequality which we have noticed would not transcend the limitations arising from those fundamental conceptions of free government which underlie all constitutional systems."

The income from that property during that period was the grantee's income, not the taxpayer's income, as it was subject to the unfettered command of the grantees, not subject to any power over it exercisable by the grantor, the source of it being a property interest or estate irrevocably vested in the grantees. *Hoeper* v. *Tax Commission,* 284 U. S. 206; *Nichols* v. *Coolidge,* 274 U. S. 531; *Corliss* v. *Bowers,* 281 U. S. 376; *Poe* v. *Sanborn,* 282 U. S. 101, 116; *Langley* v. *Commissioner,* 61 F. (2) 796; *Bing* v. *Bowers,* 22 F. (2) 450. The income in question was not taxable to taxpayer because he did not own that income, or have any beneficial interest therein when it accrued, and did not have the power, either alone or in conjunction with any person, to revest in himself the title to the property interest or estate which was the source of that income. The thing granted being the estate or property interest which produced the income in question, not future income earned by

the grantor or produced by property which he continued to own, rulings such as those made in the cases of *Lucas* v. *Earl*, 281 U. S. 111, and *Burnet* v. *Leininger*, 285 U. S. 136, are not applicable.

Conclusion.

For reasons stated, your petitioner respectfully prays that a writ of certiorari issue to enable this Court to review the judgment of the Circuit Court of Appeals in this case.

Dated July 17, 1940.

JAY C. HORMEL,
By R. C. ALDERSON,
Counsel for Petitioner.

Of Counsel:

S. D. CATHERWOOD,
CATHERWOOD, HUGHES & ALDERSON.

APPENDIX.

Revenue Act of 1934, c. 277, 48 Stat. 680 (U. S. C. A., Title 26, Sec. 22):

SEC. 22. Gross Income.

(a) General Definition.—"Gross Income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

Constitution of the United States, Article V of the Amendments (U. S. C. A. Constitution, Part 1, page 39):

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb; nor shall be compelled in any Criminal Case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

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CHARLES ELMORE CROPLEY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 257.

JAY C. HORMEL,

Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR PETITIONER.

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IN THE

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OCTOBER TERM, 1940.

No. 257.

JAY C. HORMEL,
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v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF FOR PETITIONER.

Opinions Below.

The opinion of the United States Board of Tax Appeals (R. 13) is reported in 39 B. T. A. 244. The opinion of the Circuit Court of Appeals (R. 42) is reported in 111 F. (2d) 1.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered April 25, 1940 (R. 50). Petition for writ of certiorari was filed July 19, 1940, and was granted October 14, 1940. The jurisdiction of this Court is conferred by Sec-

tion 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

Questions Presented.

The petitioner in 1934 created three trusts, identical in terms, each for the benefit of a minor child of petitioner and in each trust declared himself and one Park Dougherty co-trustees of certain property to pay the net income therefrom, up to a certain amount, on receipt, to Germaine D. Hormel, petitioner's wife, as guardian of the child for whose benefit the trust was created. Excess income was to be paid to the grantor. (Such excess income is not involved in this appeal.) Each trust was to terminate at the expiration of three years or upon the earlier death of the taxpayer or the minor child named, whereupon the corpus was to be restored to the grantor or his estate. In a statement accompanying notice of deficiency under the 1934 Revenue Act, the Commissioner cited only Section 166 of that Act, and Article 166-1 of Regulations 86, as amended by T. D. 4629; before the Board of Tax Appeals he relied only on that section and on Section 167 of that Act. Before the Circuit Court of Appeals he abandoned reliance on Section 166 and asserted liability under Section 22 (a) of that Act. The questions are:

1. Was the question of the liability of the petitioner herein under Section 22 (a) of the Revenue Act of 1934 properly before the Circuit Court of Appeals for decision?

2. If the first question be decided adversely to the petitioner herein, did the Circuit Court of Appeals err in holding that upon the facts presented to the Board of Tax Appeals petitioner is liable for taxation in respect of such income under Section 22 (a) of the Revenue Act of 1934?

Statutes and Regulations Involved.

The statutes and regulations involved will be found in the Appendix, *infra,* page 26.

Statement.

Petitioner, a resident of Minnesota, hereinafter referred to as taxpayer, created three irrevocable trusts on July 16, 1934 (R. 30-37) for the benefit of his three minor sons, respectively. He named himself and another, who accepted the trusts, as co-trustees, and conveyed stock of Geo. A. Hormel & Company to said co-trustees. It was provided in each trust that the trustees should receive and hold the securities in trust, collect the dividends and pay the same, when received, up to $2,000 per year to his wife, Germaine D. Hormel, as guardian "for the use and benefit of" her ward, taxpayer's son, and pay the excess, if any, to the taxpayer (R. 30). Each trust was to terminate at the end of three years from date or upon the earlier death of the taxpayer or the son named in the trust. Upon the termination of the trust, the corpus or principal was to belong to the taxpayer, or, in case of his death, to his heirs or the persons named in his will. The co-trustees were given power to appoint proxies to vote the stock held in trust and to exercise voting powers (R. 30). At no time did power exist to revest in the taxpayer as beneficial owner the corpus or principal, or to revoke, alter or amend the trust (R. 31). The guardian or ward was prohibited from encumbering or selling any interest in the trust estate or any dividends therefrom prior to actual receipt. No powers of management resided in the grantor and the trustees' powers were quite limited (R. 30, 31).

In the years 1934 and 1935, all income of the trusts was paid to Gefmaine D. Hormel as guardian, in accordance with the terms thereof and was included in her returns as such (R. 29). The taxpayer did not include said income in his returns (R. 7, 11). Respondent (hereinafter referred to as the "Commissioner") included said dividends in petitioner's gross income and assessed a deficiency, basing his action solely upon Section 166 of the Revenue Act of 1934 (26 U. S. Code, Section 166, 48 Stat. 729) and Article 166-1 of Regulations 86 as amended by T. D. 4629 (R. 8 to 10). We quote as follows from the deficiency statement of the Commissioner:

> "Section 166 of the Revenue Act of 1934 provides:
>
> 'Revocable Trusts.
>
> 'Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—
>
> '(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or
>
> '(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,
>
> then the income of such part of the trust shall be included in computing the net income of the grantor.'
>
> "Since it is the purpose of the Revenue Act of 1934, as provided in section 166, to tax the income to the grantor if at any time in the future the grantor or another not having a substantial adverse interest may, under power specifically vested by the trust instrument, revest title to the corpus of the trust in the grantor, it would seem to follow that the Revenue Act contemplates taxing the income to the

> grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period'' (R. 8).

Said statement thereupon quotes from and discusses Article 166-1 of Regulations 86 quoted in the Appendix hereto, and then states as follows:

> "In view of the above, it is the opinion of this office that, since you, the grantor, may revest title to the corpus of the trusts in yourself if you survive your wife, and at the end of three years with respect to the trusts for the three sons, they are revocable trusts under section 166 of the Revenue Act of 1934 and article 166-1 of Regulations 86 as amended by Treasury Decision 4629, and the income therefrom is taxable to you'' (R. 10).

The Taxpayer appealed to the Board of Tax Appeals and in proceedings before the Board the facts were stipulated (R. 28 and 29); the stipulation concluded with the following paragraph:

> "For income tax purposes the sole question involved for the Board to decide is whether any or all the items of income set forth in paragraph 7 of this stipulation are taxable to petitioner *as determined by the respondent.*'' (Italics ours.)

It will be observed from the quoted portion of this stipulation that the litigating parties were stipulating the facts solely with reference to Section 166 of the Revenue Act of 1934.

The Commissioner, in the hearing before the Board, relied solely upon Sections 166 and 167 of the Revenue Act of 1934 (R. 44). The Board entered an order on March

28, 1939 eliminating the deficiencies (R. 22), following its decision that neither of said sections was applicable (R. 13-19). The decision by Board Member Murdock (39 B.T.A. 244; R. 13) was reviewed by the full Board (*id.* 248; R. 19). There was a dissent on the ground that the income was taxable under the following quoted portion of Section 167:

> "(a) Where any part of the income of a trust—
>
> * * * * *
>
> (2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;
>
> * * * * * *
>
> then such part of the income of the trust shall be included in computing the net income of the grantor."

The Commissioner, in his petition for review to the Circuit Court of Appeals, assigned as error the failure of the Board to hold that such income was taxable either under Section 166 or Section 167 (R. 25). No other section of the Act is mentioned in the assignments of error. Although they are six in number, they are, except as stated, of the general nature usually found supporting specific assignments of error.

In his brief before the Circuit Court of Appeals, the Commissioner for the first time injected into the case consideration of Section 22(a) of the Revenue Act of 1934; in said brief he argued that the taxpayer did not give up sufficient interest in the trust income or the trust corpus to avoid taxation under Sections 166, 167 and/or 22(a) of the Revenue Act of 1934, and further that the taxpayer retained sufficient interest in the income and corpus to

justify taxing him under Sections 166, 167 and/or 22(a) considered together and read as a whole (R. 45). The taxpayer, in a supplemental brief, challenged the right of the Commissioner to raise this point for the first time in the Circuit Court of Appeals (R. 47). The Commissioner, in his answering brief, abandoned his contention that Section 166 was applicable and asserted that the income from the trusts was, for purposes of taxation, the income of the taxpayer under Sections 22(a) and 167 (R. 47), and that the Court was not precluded from considering the applicability of Section 22(a).

The Circuit Court of Appeals found that the Board was right in deciding that Section 167 was not applicable to the trusts (R. 47). The Court, however, found on authority of *Helvering* v. *Clifford,* 309 U. S. 331, that the income of the trusts was the income of the taxpayer and the decision of the Board was reversed, the Court stating that

> "the question of the right of this Court to reverse the Board, which decided correctly the only questions expressly presented to it, is not free from doubt" (R. 48).

Specification of Errors to be Urged.

The Circuit Court of Appeals erred:

1. In not limiting the issues in the case before it to the questions presented to the Board of Tax Appeals, and in allowing questions of law not presented or passed upon before the Board, to be raised; in particular, allowing the consideration of Section 22 (a) of the Revenue Act of 1934.

2. In reversing the Board of Tax Appeals which decided correctly the only questions presented to it.

3. In holding that the trust income here involved was taxable to petitioner under Section 22 (a) of the Revenue Act of 1934, on the authority of *Helvering* v. *Clifford,* 309 U. S. 331.

Summary of Argument.

We shall contend:

(1) That the income from the trusts is not taxable to the taxpayer under Section 166 of the Revenue Act of 1934, firstly, because this contention was abandoned by the Commissioner before the Circuit Court of Appeals and, secondly, because of the decision of this Court in *Helvering* v. *Wood,* 309 U. S. 344.

(2) That the Circuit Court of Appeals was correct in holding that no income from the trusts is taxable to the taxpayer under Section 167 of the Revenue Act of 1934 because upon the facts stipulated by the parties and found by the Board of Tax Appeals no part of the income from the trusts (other than excess income not involved in the case at bar) could in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition thereof be distributed to the grantor.

(3) That under the rules of appellate practice required by this Court to be followed by Circuit Courts of Appeals in hearing appeals from the Board of Tax Appeals the Commissioner should not have been heard to urge as a ground of reversal of the Board liability of the taxpayer under Section 22 (a) of the Revenue Act of 1934, this question not having been raised either in the deficiency notice of the Commissioner or by the Commissioner before the Board or in his assignments of error on appeal from the

Board to the Circuit Court of Appeals. This rule is not only laid down by this Court for the guidance of the Circuit Courts of Appeals but is enforced by this Court with respect to appeals here and is consistent with the general law on that subject.

(4) That even were the point open for consideration the facts of this case do not bring it within the purview of the decision of this Court in *Helvering* v. *Clifford,* 309 U. S. 331. The facts found by the Board and the provisions of the trusts involved in the two cases differ in vital particulars affecting this question.

POINT I.

The income from the trusts was not taxable to the grantor under Section 166 of the Revenue Act of 1934.

It does not seem necessary to argue this point. As shown above, page 7, although liability was originally predicated by the Commissioner on Section 166 of the Revenue Act of 1934, all contention under this section was abandoned by him in the Circuit Court of Appeals. Furthermore, the decision of this Court in *Helvering* v. *Wood,* 309 U. S. 344, dealing with a similar trust, is conclusive.

POINT II.

The income from the trusts was not taxable to the grantor under Section 167 of the Revenue Act of 1934.

At the time of preparing this brief it is not known whether the Commissioner will endeavor to support the judgment of the Circuit Court of Appeals by invoking Section 167 of the Revenue Act of 1934. It seems clear that

said section is not germane to the problem before this Court. The portion thereof considered by the Court of Appeals reads as follows:

> "(a) Where any part of the income of a trust—
>
> * * * * * *
>
> (2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor;
>
> * * * * * *
>
> then such part of the income of the trust shall be included in computing the net income of the grantor."

It is obvious from the provisions of the trust and a reading of the section that no person specified in the section had any discretion to dispose of the income to the grantor. Section 167 deals not with trusts revocable as to corpus referred to by the Commissioner in his deficiency statement, but solely with the disposition of the income. There can be no question under the wording of the trusts (R. 30, 31) and the stipulation of facts (R. 28, 29) that the income from the trusts up to $2,000 per annum was payable only to the guardian of the minors for their benefit and could not properly have been paid to any one else.

The income of a minor child payable to a guardian must be disposed of by that guardian for the benefit of the child under the powers of visitation of the Court at all times and in all things.

Section 8935, *Mason's Minnesota Statutes*, 1927, Vol. 2, page 1761, provides as follows:

> "Whenever a minor child of a living parent has property sufficient for his maintenance and education in a manner more expensive than such parent

> can reasonably afford, under all the circumstances, the expenses of the education and maintenance of such minor may be defrayed out of his own property, in whole or in part, as shall be deemed reasonable by the court."

This section was amended March 29, 1935 (Laws of Minn., 1935, Chap. 72, Sec. 135, effective July 1, 1935), to read as follows:

> "Guardian's Duties.—A guardian shall be subject to the control and direction of the court at all times and in all things. A general guardian of the person shall have charge of the person of the ward. A general guardian of the estate shall (1) pay the reasonable charges for the support, maintenance, and education of the ward in a manner suitable to his station in life and the value of his estate; *but nothing herein contained shall release parents from obligations imposed by law for the support, maintenance, and education of their children.*" (Italics ours.)

There is nothing in the record which would lend support to a contention that the trusts were established to discharge the taxpayer's legal obligation to support his children. In the case at bar the Circuit Court of Appeals decided the question of liability under Section 167 favorably to the taxpayer (111 F. (2d) at page 4; R. 47). Its reasoning, we submit, is unassailable. We cannot believe that the Commissioner will seriously urge any contention under this section. In *Helvering* v. *Wood,* 309 U. S. 344, which involved a trust similar in many cardinal features to those in this case, the Commissioner expressly abandoned all contention under Section 167 in the Circuit Court of Appeals and made no attempt to assert liability thereunder before this Court.

POINT III.

The Commissioner's contention that this case is governed by Section 22 (a) of the Revenue Act of 1934 should not have been considered or passed upon by the Circuit Court of Appeals.

As we have shown above, the Commissioner, representing one of the great departments of the government, assessed a deficiency against the grantor solely upon the authority of Section 166. We refer again to the statements of the Commissioner appearing in the Record, pages 8 and 10, quoted pp. 4, 5, *supra*.

This case was tried before the Board entirely upon stipulation. Stipulations often serve the useful function of waiving contentions or eliminating issues. This stipulation concludes with the following words:

> "For income tax purposes the sole question involved for the Board to decide is whether any or all the items of income set forth in paragraph 7 of this stipulation are taxable to petitioner *as determined by the respondent*" (R. 29). (Italics ours.)

This provision was drafted by the Commissioner's office. Ordinary canons of construction as well as common sense require that all of the wording of a provision which has been carefully drafted by counsel should be given effect. Unless the words "*as determined by the respondent*" are to be left without any meaning they must be given the connotation for which we contend, to wit: that the issues were limited to determining whether the income was taxable to the petitioner upon the grounds set forth by the Commissioner in his deficiency statement. If it had been

intended that he could at any stage of the litigation, on trial or on appeal, raise any issue occurring to him there would have been no point in including the italicized words.

The Commissioner's contention, upon which he has heretofore leaned so heavily in this and other litigations, that by referring in his statement to Article 166-1 of Treasury Regulations 86 he in effect called to taxpayer's attention Section 22 (a) is, we submit, with all deference, both specious and disingenuous. The regulation was not propounded under Section 22 (a); it was propounded under Section 166 and, as appears from the introductory statement to the Regulations, it was applicable only to Section 166.* The Commissioner's statement dealt only with Section 166. Before the Board he never mentioned Section 22 (a). How then can he assert that there was at any time prior to the filing of his brief in the Circuit Court of Appeals any *bona fide* intention on his part to rely on, litigate or assert liability under Section 22 (a)? The Commissioner's position more candidly stated is that notwithstanding his failure to litigate the question below he can as a matter of right litigate the question above. Such is the

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* We quote as follows from page III of the introductory statement to Treasury Regulations 86:

> "The plan has been adopted of using the numbers of the sections of the Act as key numbers, followed by a dash (—), with the number of the article placed after the dash. By this means anyone who desires to learn how a given section or subsection of the Act has been interpreted by the Bureau can readily and quickly find that interpretation by using the key number. Thus, if one desires to learn what interpretation has been placed on section 26 of the Act, he should turn to article 26—1 of the regulations."

Article 166—1 contains no reference to Section 22(a) or the regulations thereunder and those regulations, although containing numerous cross references to related provisions of the 1934 Act and of Regulations 86, make no reference to Section 166 or Article 166—1.

issue now tendered and the *only* issue now tendered. It is submitted that under the well settled practice of this Court, both in its instructions to the Circuit Courts of Appeals for the hearing of appeals from the Board and in its consideration of questions presented to this Court, the Commissioner was foreclosed from seeking reversal of the Board because of alleged liability of the taxpayer under Section 22 (a).

In *General Utilities & Operating Company* v. *Helvering*, 296 U. S. 200, it appeared that the Board of Tax Appeals had set aside a deficiency in income tax made by the Commissioner against the General Utilities & Operating Company (29 B. T. A. 934). On appeal to the Circuit Court of Appeals two grounds for reversal were urged by the Commissioner. On the first ground the Circuit Court of Appeals sustained the Board. The second point raised by the petitioner had not been urged before the Board and as to this the Circuit Court of Appeals in its opinion states, 74 F. (2d) 972, at page 975:

> "As to the second point raised by the petitioner, it is contended on behalf of the respondent that this point, not having been raised before the Board, cannot now be urged before us for the first time. We cannot agree with this conclusion."

Thereupon the Circuit Court of Appeals reversed the Board upon the second point and remanded the case.

When the case came here, Mr. Justice McReynolds, speaking for a unanimous court, said (296 U. S. at pp. 206, 207):

> "The second ground of objection, although sustained by the court, was not presented to or ruled upon by the Board. The petition for review relied

wholly upon the first point; and, in the circumstances, we think the court should have considered no other. Always a taxpayer is entitled to know with fair certainty the basis of the claim against him. Stipulations concerning facts and any other evidence properly are accommodated to issues adequately raised.

* * * * * *

Here the court undertook to decide a question not properly raised. Also it made an inference of fact directly in conflict with the stipulation of the parties and the findings, for which we think the record affords no support whatever. To remand the cause for further findings would be futile. The Board could not properly find anything which would assist the Commissioner's cause."

Very shortly thereafter this Court had before it the same problem in *Helvering* v. *Salvage,* 297 U. S. 106. In that case the taxpayer appealed to the Circuit Court of Appeals from an adverse ruling of the Board. The Court of Appeals, 76 F. (2d) 112, reversed such decision and in so doing took under consideration the Commissioner's defense of estoppel, not asserted below. On this point the Court of Appeals agreed with the taxpayer and found there was no estoppel. Nevertheless, this Court criticized the practice of giving consideration to a point not raised before the Board. We quote from the opinion, 297 U. S. 106 at p. 109:

"The defense of estoppel was not before the Board. Under what we regard as the correct practice, *General Utilities & Operating Co.* v. *Helvering,* 296 U. S. 200, the court should have passed the point. Furthermore, the facts disclosed give it no support."

In applying the similar rule which obtains in this Court as to points not raised in the Board or the Circuit Court of Appeals, Mr. Justice Stone, speaking for the Court in *Blair, Commissioner* v. *Oesterlein Co.*, 275 U. S. 220, 225, stated that "there are specially cogent reasons why this rule should be adhered to when the question involves a practice of one of the great departments of the Government."

Where a department of the Government after due consideration notifies a taxpayer that by reason of certain provisions of the law he has incurred liability to the Government, what is the taxpayer to do? Is he to scan the revenue acts for every possible section under which liability could be asserted and then seek to convince the Commissioner that he is not liable under any of them—notwithstanding that the Commissioner has only asserted liability under one of them? Again, when the Commissioner has overruled the taxpayer's objections and the taxpayer has petitioned the Board of Tax Appeals to consider the point, is the taxpayer to be called upon to file an encyclopedic brief before the Board and to raise questions of possible liability that have not been asserted by the Commissioner? Yet, in effect this is the practice for which the respondent is contending. He is contending in effect that after he has had his day in the court below and has lost the case he may for the first time on appeal assert grounds of liability never before asserted in the case, never before considered by the taxpayer or by the Board of Tax Appeals and seek reversal and win his victory as the result of an afterthought disclosed by the weakness of his case as litigated.

It is pertinent to observe that the rule of appellate practice which this Court has laid down for the Circuit Courts of Appeals is applied by it to appeals heard here

where the point was not raised in the Circuit Court of Appeals.

Helvering v. *Wood*, 309 U. S. 344;
Burnet v. *Commonwealth Improvement Co.*, 287 U. S. 415, 418;
Helvering v. *Tex-Penn Oil Co.*, 300 U. S. 481;
Helvering v. *Minnesota Tea Co.*, 296 U. S. 378.

A succinct statement of the fundamental reasons underlying this rule of practice is to be found in *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, at page 498:

> "The taxpayers were entitled to know the basis of law and facts on which the Commissioner sought to sustain the deficiencies. His failure earlier to present the question leaves this Court without the assistance of decision below."

It is not without interest that the Circuit Courts of Appeals have almost invariably followed this rule of practice in appeals from the Board of Tax Appeals.*

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* *Helvering* v. *Achelis*, 112 F. (2d) 929 (C. C. A. 2);
Loeb v. *Commissioner*, 113 F. (2d) 664 (C. C. A. 2);
Pfeiffer v. *Commissioner*, 88 F. (2d) 3 (C. C. A. 2).
But see *Commissioner* v. *Berolzheimer* (C. C. A. 2) decided December 23, 1940 (not officially reported);
Kraft v. *Commissioner*, 111 F. (2d) 370 (C. C. A. 3);
Philips v. *Commissioner*, 112 F. (2d) 721 (C. C. A. 3);
Commissioner v. *Richter*, 114 F. (2d) 452 (C. C. A. 3), now before this Court No. 516;
Groves v. *Commissioner*, 99 F. (2d) 179 (C. C. A. 4);
Rhodes v. *Commissioner*, 111 F. (2d) 53 (C. C. A. 4).
But see *Legg's Estate* v. *Commissioner*, 114 F. (2d) 760 (C. C. A. 4);
Glassell v. *Commissioner*, 42 F. (2d) 653 (C. C. A. 5);
Sakaba Oil Corp. v. *Commissioner*, 71 F. (2d) 370 (C. C. A. 5);
Covington v. *Commissioner*, 103 F. (2d) 201 (C. C. A. 5);
Hudson v. *Commissioner*, 99 F. (2d) 630 (C. C. A. 6);
Tricou v. *Helvering*, 68 F. (2d) 280 (C. C. A. 9);
Kottemann v. *Commissioner*, 81 F. (2d) 621 (C. C. A. 9);
Schoenfeld v. *Commissioner*, 103 F. (2d) 964 (C. C. A. 9).

This is, of course, a general rule of appellate practice. *Virtue* v. *Creamery Package Co.*, 227 U. S. 8, 38. As this Court observed in *Blair* v. *Oesterlein Co.*, 275 U. S. 220, 225:

> "We think the question suggested is not properly before us. It was not specifically raised on the record before the Board or either court below and, so far as appears, was not considered by any of them. We were asked to grant certiorari only to pass upon the question whether the Commissioner's determinations under §§327 and 328 may be appealed to the Board of Tax Appeals. This Court sits as a court of review. It is only in exceptional cases, and then only in cases from the federal courts, that questions not pressed or passed upon below are considered here. *Duignan* v. *United States*, 274 U. S. 195. There are specially cogent reasons why this rule should be adhered to when the question involves a practice of one of the great departments of the government."

Let us consider for a moment the reason given by the Circuit Court of Appeals in this case for departing from this well-established rule. At the outset of its discussion of the point the Circuit Court states (111 F. (2d) at p. 5; R. 48) that the question of its right to reverse the Board on such a point "is not free from doubt". It then finds that this is an exceptional case which justifies it in departing from the rule. What are the exceptional circumstances? They boil down to this: that while the appeal was pending this Court found adversely to a taxpayer in *Helvering* v. *Clifford*, 309 U. S. 331, in which case was involved a trust indenture bearing certain similarities to the trusts in this case. Let us assume for the moment that the facts in this case are on all fours with the facts in the *Clifford* case and that had the point been presented to the Board this Court

would be of the opinion that the Board should impose liability upon the taxpayer. Why should that change the rule of appellate practice? In the *Clifford* case the question was presented squarely to the Board and both the Board and the taxpayer had full opportunity to consider, discuss and litigate the issue. The record on appeal in the *Clifford* case shows that the taxpayer's petition to the Board was filed on May 13, 1937 and the answer of the Commissioner was filed on July 9, 1937. The hearing therein was held on June 20, 1938 and on September 27, 1938 the Board entered its decision favorable to the Commissioner. Can it be said that in the case at bar which was heard by the Board of Tax Appeals on June 27, 1938 (R. 1), one week after the hearing in the *Clifford* case, the Commissioner was unaware of arguments which he presented to the Board of Tax Appeals in the *Clifford* case and which was decided by the Board in that case favorably to him in the same year? In the opinion of the Board in the *Clifford* case it is stated that the retained interest and powers of the taxpayer were so substantial that the securities may be properly regarded as his property and the Board closed its opinion by stating

> "We need not discuss respondent's further contentions that petitioner is also taxable under the provisions of Sections 166, or 167, Revenue Act of 1934 or under the 'family maintenance' doctrine." (Record in *Clifford* case, p. 16.)

Here then we have the Commissioner in the *Clifford* case successfully asserting liability against the taxpayer under Section 22(a) of the Revenue Act of 1934. During the same year and almost at the same time a hearing in the case at bar is held, and in this case no liability is asserted

except under Section 166 and Section 167. Even then the Commissioner did not assert error on appeal to the Circuit Court of Appeals predicated on Section 22 (a).* Urgent as may be the needs of the Government for revenue we do not believe that its needs are so pressing that it should ask the court to sanction practice such as this. As this Court observed in the *Wood* case after citing *Burnet v. Commonwealth Improvement Co.*, 287 U. S. 415:

> "It is not apparent why a less strict rule is necessary in order adequately to protect the revenue" (309 U. S. at p. 349).

POINT IV.

Even were the point available for consideration, Section 22 (a) of the Revenue Act of 1934 does not render the income of the trusts in this case taxable to petitioner.

Section 22 (a) so far as pertinent reads as follows:

> "Sec. 22. Gross Income
>
> (a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or

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* The stringent rule of the Circuit Court of Appeals for the 8th Circuit that it will not consider points not covered by specific assignments of error is found in *Krause v. Snyder*, 87 F. (2d) 723, 725 (C. C. A. 8th). Under its own rule regarding assignments of error the court should not have considered any argument based on Section 22 (a).

> interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever * * *" (U. S. C., Title 26, Sec. 22).

As we have set forth in Point III above, it is our contention that the instant case does not involve the question of taxability of these trusts under Section 22 (a). But even were the point here for decision, we believe that the Commissioner's argument would fail and that the decision of the Circuit Court of Appeals should be reversed. It is submitted that the Court below misapplied the rule set forth in *Helvering* v. *Clifford*, 309 U. S. 331, inasmuch as there are many fundamental differences between the case at bar and the *Clifford* case. It might be called to the Court's attention that the Board of Tax Appeals, the triers of fact in the *Clifford* case, found specifically that the husband, taxpayer, was the owner of the corpus for the purposes of Section 22 (a). This Court there stated:

> "Thus, where, as in this case, the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership, we cannot say that the triers of fact committed reversible error when they found that the husband was the owner of the corpus for the purposes of Section 22 (a)" (p. 336).

Again, at a later point, the Court stated:

> "The failure of Congress to adopt any such rule of thumb for that type of trust must be taken to do no more than to leave to the triers of fact the initial determination of whether or not on the facts of each case the grantor remains the owner for purposes of Section 22 (a)" (p. 338).

In other words, we start out with the premise of not disturbing a decision by the triers of fact. The triers of fact in this case found adversely to the Commissioner on the only issues presented to them by the litigants.

The courts have recognized in general that the grantor of a trust may be the owner in substance of the income of a trust by virtue of his unfettered command of the corpus or income and the use of the income by the grantor to satisfy his obligations. At no point before the Board of Tax Appeals was this contended for, as can be seen by the findings of the Board (R. 16 and R. 18) and at no time did the Commissioner contend that the trusts were lacking in substance (R. 18).

There are vital points of distinction between the trusts in the two cases:

(1) In the *Clifford* case the grantor was sole trustee. Here the grantor and another were co-trustees. As co-trustees they must act jointly in dealing with the trust estate. This limits the power and control of the grantor in the instant trusts.

See *Scott on Trusts*, Section 194:

> "Where there are two or more trustees, it is essential that they all concur in the exercise of the powers conferred upon them."

American Law Institute Restatement of the Law of Trusts, Section 194:

> "If there are two or more trustees, action by all of them is necessary to the exercise of the powers conferred upon them as trustees. If one of them refuses to concur in the exercise of a power, the others cannot exercise the power. In such a case,

however, if it appears to be for the best interest of the trust that there should be an exercise of the power, the court may on the application of a co-trustee or beneficiary direct its exercise."

See also

Winslow v. *Baltimore & Ohio Railway Co.*, 188 U. S. 646;
Morville, Jr. v. *Fowle*, 10 N. E. 766, 768 (Mass.);
Perry on Trusts and Trustees, 7th Edition, paragraphs 411 and 412.

(2) The trust in the *Clifford* case authorized the sale, exchange, mortgage, and pledge of trust property in the absolute discretion of the grantor of the trust. There were no such unusual powers granted in the case at bar.

(3) In the Clifford trust the grantor trustee had power to invest and reinvest corpus and income without restriction, to compromise claims, to hold stock in the trustee's name as an individual. No such powers are in the Hormel trusts.

(4) The Clifford trust authorized accumulation of income. The Hormel trusts require the payment to the beneficiaries of the income on receipt (R. 33), and this was done (R. 29).

(5) The income in the Clifford trust was subject to disposition by Mrs. Clifford, the wife of grantor. In the Hormel trusts the income goes to a guardian subject to visitation by the court (*supra*, pp. 10, 11). And in a trust such as this, even the sale of the trust *res* would be subject to visitation by the Minnesota District Court. See Section

8100-1 *Mason's Minnesota Statutes* 1927, Vol. 2, p. 1622 (Appendix, p. 30); *Mayall* v. *Mayall,* 63 Minn. 511, 65 N. W. 942.

Is it not fairly to be inferred that the triers of fact in this case, since they decided favorably to the taxpayer, reaching a conclusion contrary to that which they contemporaneously reached in the *Clifford* case, were impressed by the differences above pointed out? This Court has indicated in its decision in the *Clifford* case that there is "no rule of thumb" to serve as a guide for all cases, and we submit it has also indicated that the large shadowland not covered by specific statutory mandate constitutes a field for exploration by those whose duty it is to determine the facts of the case. Occasional nice distinctions may have to be drawn and cases will be found on both sides of the line, albeit very close to it. We take it that this Court in deciding the *Clifford* case has not assumed the tremendous burden of deciding on which side of that line all tax cases involving term trusts are to be placed, but has rather announced general principles for the guidance of the courts below, leaving the analysis of the facts of each case to them. If we have not misapprehended the principles laid down by this Court in the *Clifford* case then it must follow that this Court, as in the *Clifford* case, will respect the decision of the Board on the only issues presented to it.

To construe the Revenue Act as requiring the taxation to the grantor of the income from trusts such as those in the case at bar, notwithstanding the findings of the Board, might render doubtful the constitutionality of such legislation under the decision of this Court in *Hoeper* v. *Tax Commission of Wisconsin,* 284 U. S. 206.

Conclusion.

It is respectfully submitted that the judgment of the court below should be reversed, and the order of the Board of Tax Appeals reinstated.

January, 1941.

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Appendix.

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, or whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest

in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o), relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means "in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question."

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 166-1 [as amended by T. D. 4629, XV-1 Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937-2 Cum. Bull. 117, 118]. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This

article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interest transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period

to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of owner-

ship with respect to the income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

Section 8100-1, Mason's Minnesota Statutes, 1927, Vol. 2, page 1622:

"Sale, mortgage, pledge, lease, etc., of property held in trust created by written instrument—Sales, etc., void, when—Authority of district court to order

sale, etc.—When any trust is expressed in the instrument creating the trust estate, every sale, conveyance, or other act of the trustee in contravention of the trust shall be absolutely void, except as in this act provided. The district court of the county wherein the property, whether real or personal, or any part thereof, held in trust is situate may, by order, on such terms and conditions as seem just and proper, authorize any such trustee, whether he be beneficially interested in such trust property or not, to sell or otherwise dispose of, mortgage or pledge all or any part of such trust property, whether real or personal, whenever it appears to the satisfaction of the court that it is necessary, or for the best interest, or for the benefit of the trust estate, or of the person or persons beneficially interested therein holding the first and present estate, interest or use, and that it will do no substantial injury to the heirs or next of kin, or others in succession, expectancy, reversion or remainder, in respect of such property."

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940.

No. 257.

JAY C. HORMEL,
Petitioner,

v.

GUY T. HELVERING, Commissioner of Internal Revenue,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

REPLY BRIEF FOR PETITIONER.

Point III of respondent's brief (pp. 21 to 27), in reply to Point II of our main brief (p. 9), is devoted to an argument that the judgment of the Circuit Court of Appeals should be sustained on the theory that this income is taxable to the grantor under Section 167 (a) (2) of the Revenue Act of 1934 reading as follows:

"(a) Where any part of the income of a trust—

* * * * * *

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest

> in the disposition of such part of the income, be distributed to the grantor;
>
> * * * * * *
>
> then such part of the income of the trust shall be included in computing the net income of the grantor."

In effect respondent's argument may be summarized as follows:

(1) That this Court should hold that the above quoted words "distributed *to* the grantor" are ambiguous and were intended to mean something like the following:

> "distributed *to or for the benefit of* the grantor, and the burden shall be on the grantor to come forward with affirmative evidence in the case of all trusts where the beneficiary is a member of the grantor's family to show that payments to such beneficiary were not for the benefit of the grantor."

(2) That the taxpayer should have volunteered evidence to prove that the income from these trusts was not actually applied by the guardian directly or indirectly (and unlawfully) for the taxpayer's benefit, notwithstanding that the stipulation of facts was framed only in the light of Section 166 and that the Government's contentions under Section 167 were first presented in its reply brief before the Board after the hearing on the merits (R. 1, 2). The fact that the taxpayer's net income exceeded $100,000 in each of the years 1934 and 1935 (R. 7, 11), exclusive of the trusts, may furnish some indication as to what the evidence would have disclosed regarding support of the children by the taxpayer, had the point actually been litigated.

(3) That if the guardian had applied the income for the benefit of the taxpayer, in violation of the guardian's duty under the Minnesota statute (our main brief, pages 10-11), the income should be taxable to the taxpayer to the same extent as if the original trust indenture had contemplated such action.

Respondent's argument seems to bear its own refutation.

The cases cited by respondent (brief, p. 22) were decided upon the theory of "substantial ownership" advanced by respondent in support of his argument herein under Section 22 (a) and were not cases involving Section 167. One is tempted to suggest that the argument above referred to is made solely to bolster what we conceive to be the weakness of respondent's position that the court below properly considered and decided questions arising under Section 22 (a). We submit that the last sentence in respondent's brief in which it is stated that the point need not be considered if the Court agrees with respondent that the grantor is taxable under Section 22 (a) lends support to this suggestion.

Our position is that Section 167, like Section 166, is unambiguous, and cannot be construed to cover a broader field than is indicated by its explicit language. In *Helvering* v. *Wood*, 309 U. S. 344, the Court states (p. 347):

> "The problem of interpretation under §166 is therefore quite different from that under §22 (a). The former is narrowly confined to a special class; the latter by broad, sweeping language is all inclusive. *Helvering* v. *Clifford, supra.* Accordingly, the wide range for definition and specification under the latter is lacking under §166. *And so far as §166 is*

concerned no apparent or lurking ambiguity requires or permits us to divine a broader purpose than that expressed.'' (Italics ours.)

This language, we submit, applies equally to Section 167 of the same Revenue Act.

February, 1941.

Respectfully submitted,

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No. 257

In the Supreme Court of the United States

OCTOBER TERM, 1940

JAY C. HUBMEL, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

We do not oppose the granting of a writ of certiorari in this case.

The taxpayer created three trusts, naming himself and another as trustees with substantial powers of control over the trust properties. The income up to a certain amount was payable to his wife for the benefit of their minor children. Excess income was to be paid to the grantor. Each trust was to terminate after three years or upon earlier death of either of the beneficaries (child or grantor) and upon such termination the corpus was to go to the taxpayer or his estate. The Commis-

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No. 857

In the Supreme Court of the United States

October Term, 1940

JAY O. HORMEL, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The majority (R. 14–19) and minority (R. 19–22) opinions in the Board of Tax Appeals are reported in 39 B. T. A. 244. The opinion of the Circuit Court of Appeals (R. 42–50) is reported in 111 F. (2d) 1.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 25, 1940 (R. 50–51). The petition for a writ of certiorari was filed July 19, 1940, and was granted October 14, 1940. The jurisdiction of this Court rests upon Section 240

(a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the Circuit Court of Appeals had authority to consider the applicability of Section 22 (a) of the Revenue Act of 1934 in the circumstances of this case.

2. If so, whether the grantor was taxable under Section 22 (a) on the trust income here involved.

3. In the alternative, whether this income was taxable to the grantor under Section 167 of the Revenue Act of 1934.

STATUTE AND REGULATIONS INVOLVED

The pertinent statute and regulations are set forth in Appendix A, *infra,* pp. 28–37.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 14–15), and supplemented by other stipulated facts (R. 28–37), are as follows:

Taxpayer is an officer of George A. Hormel & Company, a Delaware corporation of Austin, Minnesota (R. 29). On July 16, 1934, he created three trusts designated as Jay C. Hormel trusts Nos. 3, 4, and 5, naming himself and one Park Dougherty as joint trustees and conveying to each trust 2,000 shares of common stock of George A. Hormel & Company (R. 15, 29). Each trust instrument recited that the trust was created for the benefit of the taxpayer and his wife as guardian of one

of their minor sons. Dividends not in excess of $2,000 per year in the case of each trust were to be paid to the taxpayer's wife, in her capacity as guardian, "for the use and benefit" of the son; excess dividends were to be paid to the grantor, as co-beneficiary (R. 15, 30, 33, 35). No title to the trust estate or any dividends from it were to vest in the guardian or child, nor were they given any power to dispose of any interest in it prior to actual payment to the guardian (R. 31, 33, 36).

Each trust was to be automatically revoked and to terminate at the expiration of three years from the date of creation or upon the earlier death of the taxpayer or the child-beneficiary. There was no provision for revocation prior to termination of the respective trusts but upon their termination the corpus was to go to the grantor, if living, or otherwise to his estate (R. 15, 30, 33, 35–36).

During the continuance of the trusts the grantor and his co-trustee had the authority to ~~use~~ appoint proxies to exercise voting power on the shares of stock held under the trusts (R. 31, 33, 36). The trustees were not liable for any loss except in consequence of willful and deliberate violation of their duties as trustees (R. 31, 33, 36). The resignation of Park Dougherty as co-trustee might be required by the beneficiaries (i. e., the grantor and his wife, as guardian), in which event, or should he for any other reason be unable to act, his successor was to be chosen by agreement between the taxpayer and his wife, as guardian (R. 30, 33, 36).

In each of the years 1934 and 1935, taxpayer's personal income exceeded $100,000. In his returns for those years he took credit for his three dependent children and did not include the income of the three trusts which was paid to the wife as guardian of the children under the terms of the trust instruments (R. 11–12, 14, 15, 29).

The Commissioner included in the taxpayer's taxable income for 1934 and 1935 the trust income payable to his wife as guardian of their minor children (R. 7–12, 15). Upon review, the Board of Tax Appeals held that the Commissioner's action was erroneous, seven members dissenting (R. 13–23). The decision of the Board was appealed to the United States Circuit Court of Appeals for the Eighth Circuit, and reversed. Taxpayer petitioned for certiorari, which was granted on October 14, 1940.

SUMMARY OF ARGUMENT

The court below properly considered Section 22 (a) of the Revenue Act of 1934, *infra*, in the circumstances of this case. Here the Board had already considered the question whether the grantor remained in substance the owner of the trust properties. Thus the change in the Circuit Court of Appeals amounts in effect to a mere change in nomenclature. This is particularly true since the same factors considered in *Helvering* v. *Clifford*, 309 U. S. 331, were enunciated in Article 166–1, Treasury Regulations 86, as amended, which

the Commissioner quoted in full in both his deficiency letter and his brief before the Board. A further point of much significance is that in the main briefs in the Circuit Court of Appeals, filed prior to the decision in *Helvering* v. *Wood,* 309 U. S. 344, both parties assumed that Section 22 (a) might properly be considered by the appellate court. Since the taxpayer had already considered the applicability of Section 22 (a), Revenue Act of 1934, *infra,* on its merits, he may be deemed to have waived any objection to it. At any rate the objection made on the basis of the *Wood* case is merely an afterthought. But even if it be thought that the question was not adequately raised before the Board, still the court below did not err in passing upon it on appeal in the light of the supervening decision in the *Clifford* case. Here there is no dispute about the facts and no basis for any contention by the taxpayer that he was in any way surprised or prejudiced.

The taxpayer clearly is taxable upon the trust income paid to his wife for the use and benefit of their minor children. The trusts were to continue for not longer than three years and upon termination the properties were to go to the grantor or his estate. The taxpayer retained enough of the attributes of ownership to justify treating him as owner altogether for income tax purposes.

In the alternative, the income is taxable to the grantor under Section 167 of the Revenue Act of

1934 which covers cases where income may, in the discretion of the grantor or of any person not having a substantial adverse interest, be distributed to the grantor. Here the income in question could have been applied by the wife in satisfaction of the grantor's legal obligations to support his minor children and such an application would be equivalent to a direct distribution to the grantor. The wife had no interest which would be substantially adverse to using the income for support of the children.

ARGUMENT

As in *Helvering* v. *Richter,* No. 516, this Term, the Government took the position before the Circuit Court of Appeals that under Section 22 (a) of the Revenue Act of 1934 the income from each trust payable to his wife as guardian for their minor son was taxable to the taxpayer-settlor. This proposition was accepted by the Eighth Circuit. It held that it was at liberty to consider Section 22 (a) despite the fact that the section was specifically referred to for the first time in the Government's "Points and Authorities" and brief in the Circuit Court of Appeals. The Court stated in its opinion (R. 50): "We regard the decision of the Supreme Court [in *Helvering* v. *Clifford,* 309 U. S. 331]—rendered after the filing of the opinion and order of the Board—as a matter bearing directly upon the right disposition of this case, and as having created a changed situa-

tion which it is our duty to recognize" (R. 50). The decision of the Board was therefore reversed upon the authority of the *Clifford* decision.

Respecting taxpayer's argument that the Circuit Court of Appeals should not have considered or passed upon the contention that the case at bar is governed by Section 22 (a) of the Revenue Act of 1934, we contend, as we have done in the *Richter* case, (1) that the issue or theory that the taxpayer-settlor should be "regarded as remaining in substance the owner of the corpus" presented by Article 166–1, as amended, and by Section 22 (a) was raised before and considered by the Board and was properly before the Circuit Court of Appeals; and (2) that in any event the Court of Appeals properly considered and disposed of the case under Section 22 (a).

Respecting the merits of the case we take the position that the terms of the trusts here involved render the grantor taxable on the trust income payable to his wife as guardian under Section 22 (a) or in the alternative under Section 167.

I

THE THEORY PRESENTED BY ARTICLE 166–1, AS AMENDED, AND BY SECTION 22 (a) WAS RAISED BEFORE AND CONSIDERED BY THE BOARD AND WAS PROPERLY BEFORE THE CIRCUIT COURT OF APPEALS

1. The original deficiency letter in the case at bar demonstrates that at the outset the taxpayer was put upon notice that one question relative to the

taxability of this trust income was whether the grantor remained in substance the owner of the corpus of the trust. It is true that the principal emphasis in support of this proposition was upon the short duration of the trust and the fact that the revesting of the corpus in the grantor in a subsequent year is thereby assured. However, there is also express reference to and quotations from Article 166–1 of Regulations 86, as amended by T. D. 4629. The deficiency notice contains the following statements (R. 8–9):

> There is in the opinion of this office no practical difference between the case where a grantor in terms has the power to revest in himself title to the corpus of the trust, and a case such as the instant case where the revesting of the corpus in the grantor in a subsequent year is assured by the express limitation on the terms of the trust indenture. This is the view taken in article 166–1 of Regulations 86, as amended by Treasury Decision 4629, XV–1, Cumulative Bulletin 140 (1936). Such article provides that section 166 of the Revenue Act of 1934 is not to be regarded as excluding from taxation to the grantor of the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. Such article defines "corpus" as "any part or the whole of the property, real or personal, constituting the subject matter of the trust."

It then quotes at length from the provisions of Article 166–1, as amended, which we shall not repeat at this point, but to which we direct the Court's attention (R. 9–10). These provisions refer to the *indicia* set forth in the *Clifford* case as pertinent to the question whether a settlor should be regarded as remaining in substance the owner of the corpus.

The taxpayer's petition to the Board of Tax Appeals, to which the deficiency notice above is attached, may be described as a summary statement of facts and a general denial of tax liability (R. 2–5). It does not refer specifically to any section of the Revenue Act or article of the Regulations. The Commissioner's answer constitutes in effect a general denial (R. 12, 13). As in the *Richter* case the hearing was entirely *pro forma:* the stipulation of facts was agreed upon in advance and made a part of the record, without further testimony or argument before the Board Member.

In the proceeding before the Board the Commissioner filed a brief in which his case was presented in much the same manner as in the deficiency notice. There again the Commissioner relied in part upon the Regulations previously referred to and quoted them in full. The contention made in the Commissioner's brief before the Board (Appendix B; *infra,* pp. 39–40) is as follows:

> The respondent contends that since it is the purpose of the Revenue Act of 1934, as

> provided in Section 166, to tax the income to the grantor if at any time in the future the grantor or another not having a substantial adverse interest may, under power specifically vested by the trust instrument, revest title to the corpus of the trust in the grantor, it follows *a fortiori* that the Revenue Act contemplates taxing the income to the grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period. There is no practical difference between the case where a grantor in terms has the power to revest in himself title to the corpus of the trust, and a case such as the instant case where the revesting of the corpus in the grantor in a subsequent year is assured by the express limitation on the terms of the trust indenture. Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate. *The situation in legal effect would not be greatly different if the trusts had been created for a month or a week.* This construction of the statute is set forth in Treasury Decision 4629, approved March 7, 1936 (C. B. XV–1, 140), amending Article 166–1 of Regulations 86. [Italics supplied.]

From the deficiency notice and the Regulations, it is therefore apparent that the general question of the taxability of the trust was before the Board of Tax Appeals and that the matter of substantial

ownership was presented to the taxpayer and to the Board.

Whether the problem came to its attention under the Regulations or was raised *sua sponte,* the Board, in the last paragraph of its opinion actually considered the application of the theory of substantial ownership to this case. Phrasing the theory as a question, the Board inquired whether cases are applicable involving "trusts created for short periods where the grantor has reserved to himself practically all of the substantial benefits as owner of the property" (R. 18). The following appears in the Board's opinion (R. 18):

> Cases have been presented to the Board involving trusts created for short periods where the grantor has reserved to himself practically all of the substantial benefits as owner of the property, and the Board has held that such trusts are lacking in substance to such an extent that the income is taxable to the grantor. See Estate of A. C. O'Laughlin, 38 B. T. A. 1120, and cases there cited. The respondent does not argue that those cases are applicable here and obviously they are not, because here the trusts were not lacking in substance during the three years of their existence. In the case of each of these trusts the income was actually paid in accordance with the provisions of the trust instrument. They did not leave to the grantor any substantial rights and interest in, control over, or man-

> agement of the trust property during the existence of the trusts. The grantor could not use the trust property for his own benefit or enjoyment. Thus, these trusts cannot be disregarded and it cannot be said that they fall within section 167 because a part of the income of the trusts might be distributed to the grantor or held for future distribution to him.

When the matter came before the Circuit Court of Appeals, it pointed out (111 F. (2d) 1, 6; R. 49) that—

> In this case there is no dispute about the facts. The question of the taxability to the taxpayer of the income of these trusts was in a broad sense before the Board. In its opinion it referred to rulings to the effect that the income of trusts under which there was reserved to the grantor practically all of the substantial benefits as owner were taxable to him.[1]

Thus it seems clear that at each step in this proceeding the taxpayer was made fully aware of the possible application of the theory of substantial ownership to the case at bar. The situation here is analogous to that in the *Clifford* case where the theory was considered by the Board and the Circuit Court of Appeals without the label of Section 22 (a). Here, too, the court below recognized that

[1] The court then quoted, as a footnote, part of the last paragraph of the Board's majority opinion, already quoted above.

the taxability of the trusts was in a broad sense before the Board. Its decision holding that the income should be deemed taxable under Section 22 (a) is analogous to the action of this Court in the *Clifford* case.[2]

In much the same way as in *Commissioner* v. *Berolzheimer* (C. C. A. 2d), decided December 23, 1940, not yet reported but found in 1941 C. C. H., Vol. 4, par. 9156, the Board here raised and considered the question whether "the provisions of each trust instrument gave the grantor such control over the corpus of the trust that 'in reality there was no trust.'" The conclusion of the Second Circuit in that case is equally applicable to these facts: "The government is doing no more here than giving new reasons why the income of the trusts is taxable against the settlers under Section 22 (a)."[3] Thus the change in nomenclature clearly does not warrant a claim of surprise, particularly where the precise factors considered in *Helvering* v. *Clifford, supra,* were enunciated in Article 166–1 which the Commissioner quoted in full in his deficiency letter and in his brief before the Board. The quoted Regulations show unmistakably that Article 166–1, as amended, is not

[2] There is no indication in the *Clifford* opinion that this Court was considering a theory of liability not raised before the Board. See 309 U. S. 331.

[3] But cf. *Helvering* v. *Achelis*, 112 F. (2d) 929 (C. C. A. 2d). There, the Circuit Court of Appeals refused to consider Section 22 (a). However, the Commissioner presented no argument and filed no brief before the Board.

based solely upon Section 166 nor confined to the types of trusts therein specified. Rather, as this Court recognized in *Helvering* v. *Clifford,* 309 U. S. 331, 334n., they show that "Art. 166–1 of Treasury Regulations 86 promulgated under § 166 of the 1934 Act" was "in 1936 amended (T. D. 4629) so as to rest on § 22 (a) also".

A further point of much significance is that in the main briefs in the Circuit Court of Appeals, filed prior to the decision of *Helvering* v. *Wood,* 309 U. S. 344, both parties assumed that Section 22 (a) might properly be considered by the appellate court (See Appendices C and D, *infra,* pp. 47–49). As pointed out in the opinion of the court below (R. 45–46):

> The taxpayer, in his answering brief, under "Points and Authorities", stated:
>
> "1. Grantor gave up sufficient interest in the trust income to avoid taxation under Sections 167 and/or 22 (a) of the Revenue Act of 1934.
>
> "2. The grantor gave up sufficient interest in the trust corpus to avoid taxation therefrom under Sections 166 and/or 22 (a) of the Revenue Act of 1934.
>
> "3. Grantor did not retain sufficient interest in the income and the corpus of the trust to justify taxing him under Sections 166, 167, and 22 (a), considered together and read as a whole."

Section 22 (a) was discussed without objection by the taxpayer who relied *inter alia* upon *Clifford*

v. *Helvering,* 105 F. (2d) 586, also decided by the Circuit Court of Appeals for the Eighth Circuit. The argument of the appeal was adjourned from December 1939 to March 1940, because of the illness of one of the taxpayer's lawyers. The opinion in the *Wood* case was rendered February 26, 1940, whereupon the taxpayer *in a supplemental brief for the first time* contended that Section 22 (a) could not properly be considered on appeal. See opinion of the court below (R. 44–47). The tardiness of taxpayer's objection demonstrates not only that he was not misled, but also raises the likelihood of a waiver of any objection to the consideration of the issue by the Circuit Court of Appeals. Since the taxpayer had already discussed the applicability of Section 22 (a) *on its merits,* the objection made on the basis of the *Wood* case amounts to no more than an afterthought.

In view of these circumstances, we submit that in both the *Richter* case and the case at bar the question as to Section 22 (a) was sufficiently before the Board to preclude any contention by the taxpayer that he was surprised or prejudiced when the point was specifically raised on appeal. It is our position that the theory of substantial ownership had already been raised and was considered by the Board, and that the only change in the Circuit Court of Appeals was in the label which the theory received. We further contend that by first answering the argument with respect to Sec-

tion 22 (a) on its merits, taxpayer waived his objection to its proper application here. Finally, we submit that even if the theory of substantial ownership was not in fact raised before or considered by the Board, nevertheless the case might be considered on appeal in the light of the supervening *Clifford* decision, especially since the facts were not in dispute and only a question of law was involved. The arguments in this connection are more fully set forth in our brief in *Helvering* v. *Richter, supra* (Points I and II thereof), to which we respectfully refer the Court. Cf. also *United States* v. *Williams,* 278 U. S. 255, 256.

II

THE GRANTOR IS TAXABLE UNDER SECTION 22 (A) BECAUSE HE REMAINED IN SUBSTANCE THE OWNER OF THE TRUST CORPUS

The court below in reversing the Board said (R. 47–48) that there are no controlling distinctions between the short-term family trusts here in suit and the trust which was involved in *Helvering* v. *Clifford, supra.* In the latter case the grantor was held taxable under Section 22 (a) on trust income paid to his wife as beneficiary where the trust was to continue for a short term of five years or until the prior death of the taxpayer or his wife. By the terms of the instrument the grantor was empowered to pay over to his wife the whole or such part of the income as he in his discretion might determine; upon termination of the trust the corpus

was to go to the grantor or his estate but any undistributed net income was to be treated as the property of the wife. Respecting the expenditure of the income which the grantor's wife was to receive from the trust, it was stipulated that she had substantial income of her own from other sources and that there was no restriction of her use of the trust income, all of which was placed in her personal checking account and intermingled with her other funds, and further that the trust was not designed to relieve grantor from liability from family or household expenses. During the continuance of the trust the grantor as sole trustee had broad powers of control over the trust property.

The facts in the case at bar closely parallel those in the *Clifford* case, with a few minor exceptions. Here the beneficiary of the trusts was the taxpayer's wife, as guardian, for the use and benefit of their minor children in amounts not to exceed $2,000 per annum for each child. There was no finding as to the use of the money disbursed. The trusts here are of shorter duration than the one in the *Clifford* case, terminating at the expiration of three years from date of creation or upon the death of either the grantor or the child beneficiary.

The only significant deviation from the *Clifford* trust is that here there were two trustees of whom one was the grantor, rather than merely one trustee, the grantor himself.

While it may be that, as urged by the taxpayer (Br. 22–23), action by both of the trustees would be necessary to the exercise of the powers conferred upon them (Restatement of the Law of Trusts, Vol. 1, Sec. 194), still the record furnishes no basis for any conclusion that Dougherty, the cotrustee, would not have complied with the grantor's wishes in regard to management of the trusteed property. A trustee as such is not a beneficially nor substantially interested party. *Reinecke* v. *Smith,* 289 U. S. 172, 174; *Morton* v. *Commissioner,* 109 F. (2d) 47, 50 (C. C. A. 7th). Moreover, the grantor and his wife could have dismissed Dougherty at any time, and under such circumstances there seems little basis for presuming that he would have opposed any authorized action proposed by the grantor with respect to the trusts. Cf. *Rollins* v. *Helvering,* 92 F. (2d) 390, 394–395 (C. C. A. 8th), certiorari denied, 302 U. S. 763; *Fulham* v. *Commissioner,* 110 F. (2d) 916, 918 (C. C. A. 1st); *Cox* v. *Commissioner,* 110 F. (2d) 934, 936 (C. C. A. 10th), certiorari denied, No. 198, this Term; but cf. *Knapp* v. *Hoey,* 104 F. (2d) 99, 102 (C. C. A. 2d).

It may also be that the co-trustees here would have no power to sell trust property in the absence of a court order (Mason's Minnesota Statutes, 1927, Vol. 3, c. 60, Sec. 8100–1), since the trust instruments did not expressly give them such power. Cf., however, *Warner Hardware Co.* v. *Shimon,* 186 Minn. 229, 234. But this did not

lessen the control of the grantor; on the contrary, it emphasized his dominion over the property placed in trust. Generally speaking, nobody could sell it without his consent and if he had wished to make a sale it is improbable that his co-trustee would have opposed application for a court order, particularly in view of the provision in the trust deeds to the effect that in case of sale of the stock initially deposited, and the substitution of other securities therefor, the income therefrom was to be trust income (R. 43, 31, 34, 37).

A further significant factor of control is that the taxpayer and his co-trustee had the power to vote the trusteed securities, all being stock of the Hormel Co., of which he was an officer. See *Helvering* v. *Fuller,* 310 U. S. 69, 76.

In these circumstances, we submit that the rule in the *Clifford* case, *supra,* is clearly applicable here, for the grantor retained enough of the attributes of ownership of the trusteed property to justify treating him as owner altogether for income tax purposes. Cf. *Du Pont* v. *Commissioner,* 289 U. S. 685, 688–689.

Moreover, the instant case is substantially similar to cases holding that the assignment of future income from property retained or services performed by the assignor does not relieve him from tax. *Helvering* v. *Horst,* decided by this Court on November 25, 1940; *Helvering* v. *Eubank,* decided by this Court on November 25, 1940; *Burnet* v.

Leininger, 285 U. S. 136; *Lucas* v. *Earl,* 281 U. S. 111; see *Reinecke* v. *Smith,* 289 U. S. 172, 177.

The grantor here assigned certain rights to income from the property placed in the trusts but he remained in substance the owner of that property and consequently is taxable on the income derived therefrom.

The taxpayer asserts (Br. 21–22) that the question as to substantial ownership is one of fact and that the Board's determination thereof should be final. But we submit that the question is essentially one of law or at least a mixed question of fact and law (cf. *Bogardus* v. *Commissioner,* 302 U. S. 34), so that the Circuit Court of Appeals was not precluded from reviewing the decision of the Board in this respect. *Commissioner* v. *Berolzheimer* (C. C. A. 2d), decided December 23, 1940, not yet officially reported, but found in 1941 C. C. H., Vol. 4, par. 9156; *White* v. *Higgins* (C. C. A. 1st), decided December 13, 1940, not yet officially reported, but found in 1941 C. C. H., Vol. 4, par. 9136.[4] And even were the question to be

[4] In the *Higgins* case, the Circuit Court of Appeals (per Magruder, J.) stated:

"A point of procedure remains. At several places in its opinion, the Supreme Court in the Clifford case seems to regard the basic issue whether the grantor remains in substance the owner of the corpus as a question of fact; calling for appropriate findings by the trier of fact. Since the issue may depend not only upon an analysis of the terms of the trust but also upon "all the circumstances attendant on its creation and operation" (309 U. S. at 335), there may

treated as one of pure fact, the result would be the same for it seems clear that under the correct rule of law there is no substantial evidence to support a finding that the taxpayer in the instant case was not in substance the owner of the corpus of each trust.

III

IN THE ALTERNATIVE, THE GRANTOR DID NOT GIVE UP SUFFICIENT INTEREST IN THE TRUST INCOME TO AVOID TAXATION UNDER SECTIONS 167 AND 22 (A) OF THE REVENUE ACT OF 1934

Section 167 (a) (2) of the Revenue Act of 1934 (Appendix A, *infra*) provides that where any part of the income of a trust "may, in the discretion of the grantor or of any person not having a substan-

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be cases where questions strictly of fact are presented. However, in the Clifford case, the considerations mentioned by the court as supporting the conclusion that the grantor remained in substance the owner of the corpus, were all derived from the terms of the trust instrument.

"In the present cases the District Court has made no finding either way on the issue whether the grantors remained owners of the corpus of the respective estates, because the court did not think that Section 213 could be considered. But on the record before us, it would not be appropriate to remand the cases for further findings of fact. The underlying facts have been stipulated, and there seems to be nothing outside the terms of the trust instruments bearing on the 'basic issue.' The District Court is in no better position than we are to draw the ultimate conclusion. An examination of the trust instruments, in the light of the Clifford case and its rationale, leads us to the conclusion that as a matter of law the income of the trusts is taxable to the respective grantors. The taxpayers are not entitled to the claimed refunds."

tial adverse interest in the disposition of such part of the income, be distributed to the grantor," then such part of the income shall be included in computing the net income of the grantor.

There is no doubt that the taxpayer was under a continuing legal obligation to support his children in accordance with their needs and station in life. *Knutson* v. *Haugen,* 191 Minn. 420. It is also settled that, for income-tax purposes, a distribution of trust income at the direction of the grantor to the discharge of such an obligation owing by the grantor is treated as the equivalent of a receipt of income by him. *Douglas* v. *Willcuts,* 296 U. S. 1, 9; *Helvering* v. *Schweitzer,* 296 U. S. 551, reversing 75 F. (2d) 702 (C. C. A. 7th); *Helvering* v. *Coxey,* 297 U. S. 694, reversing 79 F. (2d) 661 (C. C. A. 3d); *Commissioner* v. *Grosvenor,* 85 F. (2d) 2 (C. C. A. 2d); *Helvering* v. *Leonard,* 105 F. (2d) 900 (C. C. A. 2d), reversed on another point, 310 U. S. 80. Accordingly, we submit that trust income, payable to the taxpayer-grantor's wife for the benefit of their minor children, which could be applied by her towards their maintenance and support, thereby relieving the taxpayer of his obligation to support his children, is income that could be distributed for his benefit or "to the grantor" within the meaning of Section 167. The only question remaining then is whether the income from the trusts under scrutiny could have been so applied.

The regulations, both as originally adopted,[5] and as amended (Appendix A, *infra*), support the construction of the statute here contended for;[6] they

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[5] Treasury Regulations 86, promulgated under the Revenue Act of 1934:

"ART. 167–1. TRUSTS IN THE INCOME OF WHICH THE GRANTOR RETAINS AN INTEREST.—* * *

"(*b*) *Test of taxability to the grantor.*—The test of the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether the grantor has failed to divest himself, permanently and definitively, of every right which might, by any possibility, enable him to have the income, at some time, distributed to him, actually or constructively. Such a distribution to the grantor occurs if the income is paid to him or to another according to the grantor's direction or if, though paid to another pursuant to the terms of the trust, the benefit of the income inures to the grantor. The income so inures if it is or may be applied in satisfaction of a legal obligation of the grantor * * *.

* * * * *

"If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

* * * * *

"(4) whether, if such distribution results in the inuring of benefits to the grantor from the application of the income in satisfaction of his legal obligation, such obligation is to pay a debt, to support dependents, to pay alimony, to furnish maintenance, and support or otherwise;"

* * * * *

[6] It is true that following the Board's decision in *Black* v. *Commissioner*, 36 B. T. A. 346, the Chief Counsel, Bureau of Internal Revenue, ruled that where trust income may, in the discretion of the trustee, be used for support of the grantor's minor children, only so much thereof as is actually so applied may be taxable to the grantor (G. C. M. 18972, 1937–2 Cum. Bull 231, 233) and that ruling was followed in *Hudson* v. *Jones*, 22 F. Supp. 938 (W. D. Okla.). But

have remained without substantial modification through the 1936 and 1938 reenactments of the law (Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 167; Revenue Act of 1938, c. 289, 52 Stat. 447, Sec. 167); we submit that the departmental construction adopted contemporaneously with the enactment of the law and of such long-continued standing should be approved. Compare *Taft* v. *Commissioner,* 304 U. S. 351.

The taxpayer does not appear to oppose our construction of the statute which has been embodied in the regulations. His position, on the contrary, appears to be that (irrespective of our

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we submit that, to the extent that it is inconsistent with the views herein expressed in the text, the ruling is incorrect and out of harmony with the regulations.

The Board of Tax Appeals has drawn a distinction between (1) cases where the trustee or guardian has the power to use trust income for support of the grantor's children and (2) cases where the grantor has retained such power as an individual. It holds that in the first type of case only the income actually so used is taxable to the grantor (*Black* v. *Commissioner*, *supra; Chandler* v. *Commissioner*, 41 B. T. A. 165, 178, appeal to the Circuit Court of Appeals for the Third Circuit pending; *Deuble* v. *Commissioner*, 42 B. T. A. 277, 288; *Johnston* v. *Commissioner*, 41 B. T. A. 550, 556); and in the latter, it holds that the grantor is taxable under Section 167 (a) (2) on all income which could have been so used. *Pyeatt* v. *Commissioner*, 39 B. T. A. 774, 780; *Whitely* v. *Commissioner*, 42 B. T. A. 402, 416–418, appeal to the Circuit Court of Appeals for the Third Circuit pending. We submit that the distinction is not substantial and should be disapproved. The statute and the regulations operate to tax the grantor in both instances.

construction) his wife had a "substantial adverse interest" to the application of the trust income in such a manner as to relieve him of his obligation to support their children. In support of his position, he cites a Minnesota statute (Mason's Minnesota Statutes, 1927, Vol. 3, 1940 Supp., c. 74, Sec. 8992–135) which reads, in part, as follows:

> 8992–135. *Guardian's duties.*—A guardian shall be subject to the control and direction of the court at all times and in all things. A general guardian of the person shall have charge of the person of the ward. A general guardian of the estate shall (1) pay the reasonable charges for the support, maintenance, and education of the ward in a manner suitable to his station in life and the value of his estate; but nothing herein contained shall release parents from obligations imposed by law for the support, maintenance, and education of their children. * * *

The quoted statutory provision clearly does not preclude a parent from discharging his obligation to support, maintain, and educate his children through the utilization of a trust device. It may assure the existence of a continuing obligation on the part of the parent, but it certainly does not purport to control the means by which the parent can discharge that continuing obligation. And no authority has been produced by the taxpayer holding or even intimating that a trust like those under scrutiny would not be an entirely appropriate

means of discharging the obligations owing by him to his children. Furthermore, and more to the point, no authority has been brought forward to support the assertion that in the circumstances here the wife would not have been fully authorized to apply the income from the trusts created by the taxpayer for the support, maintenance, and education of his children. In the absence of such authority, forbidding the application, there would appear to be no reason for regarding the wife as having a "substantial adverse interest" to such an application of the trust income. *Reinecke* v. *Smith,* 289 U. S. 172, 174; *Morton* v. *Commissioner,* 109 F. (2d) 47, 50 (C. C. A. 7th). The taxpayer therefore has failed to meet the burden of proof required of him in this type of case, and the trust income is taxable to him under Section 167 (a) (2). See *Helvering* v. *Leonard,* 310 U. S. 80, 87; *Helvering* v. *Fitch,* 309 U. S. 149, 151, 156.

Moreover, we submit, the record in this case does not show what use the wife made of the trust income which was paid to her for the benefit of the minor children. It is quite possible, so far as appears, that such income was in fact used for their support, maintenance, or education. If that is the case, then the taxpayer (their father) would appear to be taxable on the income which was used to discharge his obligation under the authority of the *Douglas* and *Schweitzer* cases cited above. And since this Court has held that the taxpayer "has the burden of establishing that his case falls out-

side the general rule of *Douglas* v. *Willcuts*" it follows that, on the present record, the income must be assumed to have been so used. See *Helvering* v. *Leonard*, 310 U. S. 80, 87; *Helvering* v. *Fitch*, 309 U. S. 149, 151, 156.

Although the question as to Section 167 (a) (2) was decided adversely to the Commissioner by the Board, seven members dissenting, and by the court below, the point is available here as a ground of defense. Cf. *Helvering* v. *Gowran*, 302 U. S. 238, 245–246; *Riley Investment Co.* v. *Commissioner*, decided by this Court on November 12, 1940, not yet reported. But it is presented only in the alternative and need not be considered if the Court agrees with us that the grantor was taxable under Section 22 (a) (pp. 7–21, *supra*).

CONCLUSION

The judgment of the court below should be affirmed.

Respectfully submitted.

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FEBRUARY 1941.

APPENDIX A

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 22. GROSS INCOME.

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * * (U. S. C., Title 26, Sec. 22.)

SEC. 166. REVOCABLE TRUSTS.

Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom,

then the income of such part of the trust shall be included in computing the net income of the grantor. (U. S. C., Title 26, Sec. 166.)

SEC. 167. INCOME FOR BENEFIT OF GRANTOR.

(a) Where any part of the income of a trust—

(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; or

(3) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, applied to the payment of premiums upon policies of insurance on the life of the grantor (except policies of insurance irrevocably payable for the purposes and in the manner specified in section 23 (o) relating to the so-called "charitable contribution" deduction);

then such part of the income of the trust shall be included in computing the net income of the grantor.

(b) As used in this section, the term "in the discretion of the grantor" means in the discretion of the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of the part of the income in question. (U. S. C., Title 26, Sec. 167.)

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 22 (a)–1. *What included in gross income.*—Gross income includes in general

compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See secs. 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets. * * *

ART. 166–1 [as amended by T. D. 4629, XV–I Cum. Bull. 140, 141 (1936), and T. D. 4759, 1937–2 Cum. Bull. 117, 118]. *Trusts, with respect to the corpus of which, the grantor is regarded as remaining in substance the owner.*—(*a*) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163, but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.

(*b*) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to

revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

(1) whether such power or ability to retake the trust corpus to the grantor's own use is effected by means of a power to revoke, to terminate, to alter or amend or to appoint;

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come;

(4) whether the power to revest in the grantor title to the corpus is in the grantor, or in any person not having a substantial interest in the corpus or income therefrom adverse to the grantor, or in both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(5) when the trust was created.

But the provisions of section 166 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the corpus. The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor

has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

In determining whether the grantor is in substance the owner of the corpus, the Act has its own standard, which is a substantial one, dependent neither on the niceties of the particular conveyancing device used, nor on the technical description which the law of property gives to the estate or interst transferred to the trustees or beneficiaries of the trust. In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor, or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the substantial incidents of ownership in the corpus.

Thus the grantor is regarded as being in substance the owner of the corpus if, in any case, the trust amounts to no more than an arrangement whereby the grantor, in the ordering of his affairs, finds it expedient to entrust for a period the title to, and custody or management of, certain of his property to a trustee, the income from such property to be used by the trustee during such period to make those expenditures which the grantor would customarily or ordinarily or naturally make and to which the grantor chooses to commit himself in advance, while

the corpus is to be held intact, for return in due course to the grantor. In such a case, it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of those property rights which consist of the right to the expected future income of the corpus for the specified period. On the other hand, if the grantor, incident to a definitive and permanent disposition of certain of his property, creates the trust in order to conserve the property, not for himself but for the donees, who will ultimately enjoy it, the provisions of sections 161, 162, and 163 are applicable.

(*c*) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; or

(B) for the term of a year and a day, then to be distributed to whomsoever the wife of the grantor shall by deed appoint (the wife not having a substantial adverse interest in the disposition of the corpus or the income therefrom); or

(C) for the term of the grantor's life, then to be distributed to John, the grantor reserving, however, the right to alter, amend, or revoke any provision of the trust instrument, upon notice of a year and a day.

In these typical cases the grantor is regarded as having retained the substantial incidents of ownership with respect to the

income-producing property since the corpus will or may once more revest in himself in (A) upon the expiration of the trust period if the grantor does not exercise his option to extend the trust, in (B) upon the designation of the grantor as distributee, by a person not substantially and adversely interested, and in (C) upon the revocation of the trust instrument or an alteration or amendment thereof, resulting in the designation of the grantor as distributee.

(*d*) If the grantor is regarded as remaining in substance the owner of the corpus the gross income of such corpus shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to the corpus as he would have been entitled to had the trust not been created.

If the grantor strips himself of the substantial incidents or attributes of ownership in the corpus retained by him so that he ceases to be regarded as in substance the owner of the corpus, the income thereof realized after the effective date of such divesting is not taxable to the grantor but is taxable as provided in sections 161, 162, and 163.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the corpus or the income therefrom. If the power to revest title in the grantor is vested in him in conjunction with such person, or is vested solely in such person, there is to be excluded in computing the net income of the grantor only the income of such part.

ART. 167–1 [as amended by T. D. 4759, *supra,* and T. D. 4860, 1938–2 Cum. Bull. 184]. *Trusts in the income of which the grantor retains an interest.*—(*a*) *Scope.*—

Section 167 prescribes that the income, or any part of the income, of certain trusts shall be taxed to the grantor, not because the grantor has retained a certain interest in the *corpus* of the trust (as in section 166), but because of his retention of a certain interest in the *income* of the trust. This article deals with the taxation of such income. The term "income," as used in this article, means any part or the whole of the income of the trust.

(*b*) *Test of taxability to the grantor.*—The test prescribed by the Act as to the sufficiency of the grantor's retained interest in the trust income, resulting in the taxation of such income to the grantor, is whether he has failed to divest himself, both permanently and definitely, of every right which might, by any possibility, enable him to have such income, at some time, distributed to him, either actually or constructively. Such a distribution to the grantor occurs within the meaning of section 167 if the income is paid to him or to another in obedience to his direction or if the income is applied in payment of premiums upon policies of insurance on the grantor's life.

For the purposes of this article, the sufficiency of the grantor's retained interest in the income is not affected by the fact that the grantor has provided that the right to so effect or direct the distribution of income is, or may at some future time be, vested in any person (either alone or in conjunction with the grantor) not having a substantial interest in the income adverse to the grantor.

If the grantor has retained any such interest in the income, such income is taxable to the grantor regardless of—

(1) whether it may be distributed currently or accumulated for future distribution;

(2) whether such distribution, either current or subject to accumulation, is fixed by the trust instrument or is dependent on an exercise of discretion;

(3) whether, if such distribution is in any way effected by or dependent on an exercise of discretion, the person exercising the discretion is the grantor or a person not having a substantial interest in the income adverse to the grantor, or both. A bare legal interest, such as that of a trustee, is never substantial and never adverse;

(4) the time or times of such distribution, whether within or without the taxable period, whether conditioned on the precedent giving of notice, or on the elapsing of an interval of time, or on the happening of a specified event, or otherwise;

(5) when the trust was created.

Thus the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Act, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation whether to pay a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable to the grantor.

If the grantor strips himself permanently and definitively of every such interest retained by him, the income of the trust

realized after such divesting takes effect is not taxable to the grantor but is taxable as provided in sections 161 and 162.

A person may have an interest that is both substantial and adverse to the grantor in the disposition of only part of the income. There is to be excluded in computing the net income of the grantor only that part of the trust income in the disposition of which such person has a substantial interest adverse to the grantor.

(c) *Income and deductions.*—If, as to any of the income, the test of taxability to the grantor is satisfied, such income shall be included in the gross income of the grantor, and he shall be allowed those deductions with respect to such income as he would have been entitled had such income been distributable currently to him.

APPENDIX B

EXCERPTS FROM THE GOVERNMENT'S BOARD BRIEF IN THIS CASE (PP.19–26)

* * * * *

The said trusts, by their every term and provision wherein the income was to be paid to the several members of the grantors' families for a limited time, and at the same time the corpus was to be supervised by the grantors or the members of their families as trustees, disclose their true purpose was to avoid surtaxes. Although the dividends were actually distributable, the beneficiaries had no right or title thereto until actually paid or delivered to them. The trust agreements contained a certain restriction upon alienation of the income before its actual payment and receipt by the beneficiaries (Article #4 of Trust 9 and Article #5 of Trusts 1, 3, 4 and 5).

The trust instruments by their own specific terms were irrevocable except by happening of the events which automatically terminated them, when the corpus "shall be deemed and treated as property owned absolutely" by the grantors as of the same time. The happening of the said events resulting in termination operated to revest the corpus in the grantors if they were ever divested.

The petitioners contend that the "income" distributed to the several beneficiaries of the trust is not taxable to them (Docket Nos. 93571 and 93572); and if so, then the transfer of the stock to the trusts

is not also subject to gift tax (Issue B of Amended Petitions, Docket Nos. S9114 and S9115). The question presented herein for decision is whether the grantors of the aforementioned trusts retained such an interest either in the corpus or the income of the trusts as to require the taxation of the income thereof to them.

The petitioners contend that the phrase "power to revest" as used in *Section 166* should be literally interpreted and that, inasmuch as the grantors did not have power to revest, but held only a reversionary interest under which the corpus of the trusts reverted to them, if living, upon the death of their wives, or the expiration of three years in the case of their children, the trusts herein involved fall outside of the scope of *Section 166*. They further contend that, even if the term "power to revest" be interpreted to include within its scope such a trust as the ones involved herein, the income of the trusts is nevertheless not taxable to the grantor because the event upon which the revesting will occur is contingent and uncertain.

The respondent contends that since it is the purpose of the *Revenue Act of 1934*, as provided in *Section 166*, to tax the income to the grantor if at any time in the future the grantor or another not having a substantial adverse interest may, under power specifically vested by the trust instrument, revest title to the corpus of the trust in the grantor, it follows *a fortiori* that the Revenue Act contemplates taxing the income to the grantor if, by the express terms of the trust instrument, title to the corpus will certainly revest in the grantor at the end of a comparatively short period. There is

no practical difference between the case where a grantor in terms has the power to revest in himself title to the corpus of the trust, and a case such as the instant case where the revesting of the corpus in the grantor in a subsequent year is assured by the express limitation on the terms of the trust indenture. Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate. The situation in legal effect would not be greatly different if the trusts had been created for a month, or a week. This construction of the statute is set forth in *Treasury Decisions 4629,* approved March 7, 1936, (C. B. XV–1, 140) amending *Article 166–1 of Regulations 86.* The article as amended contains the following provisions:

> Trusts with respect to the corpus of which the grantor is regarded as remaining in substance the owner.—(a) If the grantor of a trust is regarded, within the meaning of the Act, as remaining in substance the owner of the corpus thereof, the income therefrom is not taxable in accordance with the provisions of sections 161, 162, and 163 but remains attributable and taxable to the grantor. This article deals with the taxation of such income. As used in this article, the term "corpus" means any part or the whole of the property, real or personal, constituting the subject matter of the trust.
>
> (b) Section 166 defines with particularity instances in which the grantor is regarded as in substance the owner of the corpus by reason of the fact that he has retained power to revest the corpus in himself. For the purposes of this article the grantor is

deemed to have retained such power if he, or any person not having a substantial interest in the corpus or the income therefrom adverse to the grantor, or both, may cause the title to the corpus to revest in the grantor. If the title to the corpus will revest in the grantor upon the exercise of such power, the income of the trust is attributed and taxable to the grantor regardless of—

* * * * *

(2) whether the exercise of such power is conditioned on the precedent giving of notice, or on the elapsing of a period of years, or on the happening of a specified event;

(3) the time at which the title to the corpus will revest in the grantor in possession and enjoyment, whether such time is within the taxable year or not, or whether such time be fixed, determinable, or certain to come:

* * * The grantor is regarded as in substance the owner of the corpus, if, in view of the essential nature and purpose of the trust, it is apparent that the grantor has failed to part permanently and definitively with the substantial incidents of ownership in the corpus.

* * * In that determination, among the material factors are: the fact that the corpus is to be returned to the grantor after a specific term; the fact that the corpus is or may be administered in the interest of the grantor; the fact that the anticipated income is being appropriated in advance for the customary expenditures of the grantor or those which he would ordinarily and naturally make; and any other circumstances bearing on the impermanence and indefiniteness with which the grantor has parted with the

substantial incidents of ownership in the corpus.

* * * it is immaterial that, at the time of the creation of the trust, an irrevocable disposition or consummated gift was made of these property rights which consist of the right to the expected future income of the corpus for the specified period. * * *

(c) For example, a grantor is regarded as remaining in substance the owner of the corpus of the trust, if he has placed it in trust for his son, John.

(A) for the term of three years, at the end of which time the trust might be extended for a like period at the option of the grantor and successively thereafter, but in the absence of such an extension the title is once more to revest in the grantor in possession and enjoyment; * * *.

The provisions of *Section 166* of the *Revenue Act of 1934* have been reenacted without alteration in the Revenue Act of 1936 in the face of its interpretation by the Commissioner, by his regulations above quoted. The substance of the Treasury Decision has also been adopted as the regulation under subsequent revenue acts.

Such article as amended provides that *Section 166* of the *Revenue Act of 1934* is not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor, for the purposes of the Act, is similarly regarded as remaining in substance the owner of the corpus. Such article defines "corpus" as "any part or the whole of the property, real or personal, constituting the subject matter of the trust."

The grantors have retained a sufficient interest in the corpus of the trust resulting in the taxation

of its income to them, in that they have failed to divest themselves, permanently and definitely, of every right which might by any possibility enable them once more to possess and enjoy in title the trust corpus.

It is true the trust instruments were irrevocable by their specific terms during the period of their existence, and the grantors had no power to revest themselves of any corpus of the trusts during the limited period. However, the trusts were automatically revoked at the end of the period without any positive action on their part.

There is no substantial distinction between a trust where the grantor has literally retained the power or ability to revest and one where the revesting takes place without any action on the part of the grantor. It would appear somewhat meaningless to distinguish between the two types of trusts.

Here the grantors, by using a different form of words, have attained the same end and will escape the surtax imposed upon them if they are not held taxable on the income.

Having in mind the purpose of the statute and the breadth of its language, it would seem to be of no consequence what particular conveyancing device—what particular strings—the grantors selected to hold in suspense their right and title to the property and the ultimate disposition of it.

Cf. *Corliss* v. *Bowers,* (1930) 281 U. S. 376, in which the Court stated: "But taxation is not so much concerned with the refinements of title as it is with actual command over the property taxed—the actual benefit for which the tax is paid." (Also see *Reinecke* v. *Smith,* (1933) 289 U. S. 172.)

It is accordingly submitted that the retention by a grantor of a reversion of the corpus of a trust after a short term of years constitutes the retention of such an interest in the corpus as will permit the taxation of the income of the trust to the grantor.

The respondent recognizes that the Board has ruled that trusts similar to the ones here involved—especially Trusts No. 1 and No. 9—do not come within the scope of *Section 166, supra.* (Cf. *Meredith Wood,* (1939) 37 B. T. A. No. 157 and cases cited; *Henry A. B. Dunning,* (1937) 36 B. T. A. 1222.) The respondent has not acquiesced in these decisions and has petitioned the higher courts for a review.

In *DuPont* v. *Commissioner,* (1933) 289 U. S. 685, the Supreme Court had under consideration the question of whether the income of trusts created for a period of 3 years, and which were irrevocable during that period, with provisions for successive extensions, was taxable to the grantor under the provisions of the Revenue Acts of 1924 and 1926. Two policies of insurance on the life of the grantor and shares of stock in a corporation were transferred to the trusts, the income from the stock to be used to keep the policies in force. It was provided as to the policies that if the trusts should terminate before the grantor's death, all interest in the policies should rest in certain named beneficiaries, of which the grantor was not one. The grantor had no power to change the beneficiaries. It was provided that if the grantor should die while the trusts were still in force, the trustees should collect the insurance and hold the proceeds in trust for the use of the beneficiaries named in

the agreements. It was further provided that if the trusts should terminate before the grantor's death, the shares of stock and any income not paid out should be transferred to the grantor. If, however, he should die while the trusts were still in force, the shares were to be divided among the grantor's children or their issue. In that case the Supreme Court decided that Section 219 (h) of the Revenue Acts of 1924 and 1926 is consistent with the Fifth Amendment of the Constitution, in its application to trusts for the payment of premiums on policies of insurance. The Supreme Court also stated:

> The case is ruled by our judgment in *Burnet* v. *Wells,* ante P. 670, upholding the validity of the contested statute. If the income of such a trust may be taxed to the grantor though he has retained to himself no reversionary interest in the principal of the trust, a fortiori that result must follow where he has made a grant of the estate for a short term of years, reserving the reversion when the term is at an end.
>
> The provisions of these deeds would require a determination in favor of the Government, though *Burnet* v. *Wells* had been decided the other way. "A statute may be invalid as applied to one state of facts and yet valid as applied to another." *Dahnke-Walker Co.* v. *Bondurant,* 257 U. S. 282, 289. Here the grantor did not divest himself of title in any permanent or definitive way, did not strip himself of every interest in the subject matter of the trust estate. During a term of three years, the trustee was to apply the income to the preservation of the policies, and while thus applying the in-

> come was to hold the principal intact for return to the grantor unless instructed to retain it longer. The situation in its legal effect would not be greatly different if the trusts had been created for a month or from day to day. One who retains for himself so many of the attributes of ownership is not the victim of despotic power when for the purposes of taxation he is treated as owner altogether.

In the above case, four Justices of the Supreme Court concurred upon the reasons stated in the last paragraph quoted above. Those same Justices who concurred in that case dissented in the case of *Burnet* v. *Wells,* (1933) 289 U. S. 670, in which case it was held that *Section 219 (h)* of the *Revenue Acts of 1924 and 1926* is constitutional. It thus appears that all of the Justices of the Supreme Court concurred in the conclusion that the retention by a grantor of a reversion of the corpus of a trust after a short term of years constitutes the retention of such an interest in the corpus as will permit the taxation of the income of the trust to the grantor.

* * * * *

APPENDIX C

Extract from Commissioner's main brief in the Circuit Court of Appeals for the Eighth Circuit, (pp. 7–8):

III

The grantor retained sufficient interest in the income and corpus of the trusts to justify taxing him under Sections 167, 166, and 22 (a), considered together and read as a whole

In addition to the considerations hereinbefore set forth, we urge that the interest retained by the grantor in the income and corpus of the trusts was sufficient to justify the Commissioner in treating him as the owner of the properties and the income therefrom and in taxing him on such income under Sections 167, 166 and 22 (a) of the Revenue Act of 1934, considered together and read as a whole. Cf. *DuPont* v. *Commissioner,* 289 U. S. 685, where irrevocable trusts to pay premiums on policies of insurance on the grantor's life were to last for a period of three years, at the expiration of which they might be extended for a similar period. In holding valid the provisions of the statute which required the grantor to account for the income of the trusts (Section 219 (h) of the Revenue Act of 1924, c. 234, 43 Stat. 253, and the Revenue Act of 1926, c. 27, 44 Stat. 9, which corresponds to Section 167 of the Revenue Act of 1934), the Court said (pp. 688–689):

"Here the grantor did not divest himself of title in any permanent or definitive way,

did not strip himself of every interest in the subject matter of the trust estate. During a term of three years, the trustee was to apply the income to the preservation of the policies, and while thus applying the income was to hold the principal intact for return to the grantor unless instructed to retain it longer. The situation in its legal effect would not be greatly different if the trusts had been created for a month or from day to day. One who retains for himself so many of the attributes of ownership is not the victim of despotic power when for the purpose of taxation he is treated as owner altogether."

Similarly, in the instant case, the trusts were to terminate after three years or the earlier deaths of the children or the grantor and upon termination the properties were to be restored to the taxpayer or his estate. The grantor was also to receive all income over the $2,000 per annum applicable to the use and benefit of each minor child. Clearly here, as in the DuPont case, the taxpayer did not part with sufficient interest in the trust properties to justify treating him otherwise than as owner of the same and taxable on the income therefrom.

APPENDIX D

Extract from respondent's main brief in the Circuit Court of Appeals for the Eighth Circuit (p. 22):

III

The grantor did not retain sufficient interest in the income and corpus of the trust to justify taxing him under Sections 166, 167, and 22 (a), considered together and read as a whole.

Here petitioner contends that the interest retained by the grantor in the income and corpus was sufficient to justify treating him as the owner of the properties and income and taxing him under the sections referred to supra, and cites the case of *Dupont* v. *Commissioner,* 289 U. S. 685. The case cited is one involving the question of payment of premiums upon life insurance policies on the grantor's life. The court merely held that the grantor did not divert himself of title in any permanent or definitive way, as during the term of the trusts the trustee was to apply the income to the preservation of policies. In the instant case, there is no restriction whatsoever upon the application and no restriction whatsoever upon the use of the income. Grantor merely holds the reversionary right, having no power to revest any of the income of the trusts for his own benefit. There is no provision in the trust agreement for alteration, amendment, or revocation. See paragraph 6, page 31 of the record.

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SUPREME COURT OF THE UNITED STATES.

No. 257.—October Term, 1940.

Jay C. Hormel, Petitioner, *vs.* Guy T. Helvering, Commissioner of Internal Revenue.	On Writ of Certiorari to the United States Circuit Court of Appeals for the Eighth Circuit.

[March 17, 1941.]

Mr. Justice Black delivered the opinion of the Court.

The Commissioner of Internal Revenue assessed a deficiency against petitioner for failure to include in his 1934 and 1935 tax returns the income of three separate trusts declared by him in 1934. Each of the declarations of trust recited that the beneficiaries were "Jay C. Hormel [petitioner himself], and Germaine D. Hormel, his wife, as guardian for their son," a different son being designated by each trust instrument. Each trust estate consisted of shares of stock in Geo. A. Hormel & Co., of which petitioner was an officer. Petitioner named himself and another as co-trustees; all dividends from each trust estate, up to $2000 a year, were to be paid to petitioner's wife as guardian for the son named in the particular trust instrument, and any excess over $2000 was to be paid to petitioner; the trusts were to expire automatically after three years, or upon the death of petitioner, or upon the death of the named son, whichever event should occur first; upon expiration of each trust, the entire principal should be the property of petitioner, his legatees, devisees, or heirs; petitioner and his wife (as guardian) had the power to remove petitioner's co-trustee at any time, and to choose a successor; the co-trustees could appoint proxies to exercise voting rights over the shares of stock making up the trust estates, and could sell the securities deposited and substitute others; it was provided that no title to the trust estates should vest in petitioner's wife, as guardian, or in his sons, and it was further provided that the wife and sons should have no power "to sell, transfer, encumber or in any manner anticipate or dispose of any interest in the trust estate"; and, finally, the trust instruments stated that the co-trustees were to be responsible for loss only upon wilful and deliberate violations of their duties.

All of the trust income for the years in question was distributed to petitioner's wife as guardian, who reported it to the federal government as guardianship income. Petitioner, in his individual returns, did not include it. The Commissioner, taking the position that petitioner should have included the trust income in his individual returns, assessed a deficiency against him, asserting that the trusts were "revocable" and the income therefore petitioner's within the meaning of section 166 of the Revenue Act of 1934.[1] The Board of Tax Appeals decided against the Commissioner, holding that the income in question was taxable to petitioner neither under section 166 nor 167,[2] the two sections expressly relied on by the Commissioner before the Board. In the Circuit Court of Appeals, the Commissioner abandoned reliance on section 166, urged that the Board was in error as to taxability under section 167, and argued that in any event the income was taxable to petitioner under section 22(a).[3] The taxpayer argued that the applicability of section 22(a) was not open for consideration, inasmuch as that section had not been relied on before the Board. The Circuit Court of Appeals, though agreeing with the Board as to non-taxability under sections 166 and 167, nevertheless ruled that section 22(a) could properly be considered, and held the income taxable to petitioner under that section. Because of a con-

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1 "Where at any time the power to revest in the grantor title to any part of the corpus of the trust is vested—

"(1) in the grantor, either alone or in conjunction with any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, or

"(2) in any person not having a substantial adverse interest in the disposition of such part of the corpus or the income therefrom, then the income of such part of the trust shall be included in computing the net income of the grantor."

2 Section 167 reads in part as follows: "(a) Where any part of the income of a trust—

"(1) is, or in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income may be, held or accumulated for future distribution to the grantor; or

"(2) may, in the discretion of the grantor or of any person not having a substantial adverse interest in the disposition of such part of the income, be distributed to the grantor; . . ."

3 " 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. . . ."

flict among the Circuit Courts of Appeals on the propriety of considering section 22(a) under these circumstances,[4] we granted certiorari. 311 U. S. —. Two questions are presented for our decision: First, Was the court below correct in holding that section 22(a) should be considered? Second, If so, was the court below justified in determining that the income of these trusts was taxable to petitioner under section 22(a)?

First. Petitioner in effect challenges the power of the Circuit Court of Appeals to pass upon any questions other than those which were directly and squarely presented in the proceedings before the Board of Tax Appeals. That court's authority to review decisions of the Board rests on statutes, which provide in part that the Circuit Courts of Appeals "have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require." 26 U. S. C. § 1141(c)(1) (Supp.1939). In general, it is the function of the Board to determine the facts of a tax controversy on issues raised before it and to apply the law to those facts; and it is the function of the reviewing court to decide whether the Board has applied the correct rule of law.[5]

Ordinarily an appellate court does not give consideration to issues not raised below. For our procedural scheme contemplates that parties shall come to issue in the trial forum vested with authority to determine questions of fact. This is essential in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide; it is equally essential in order that litigants may not be surprised on appeal by final decision there of issues upon which they have had no opportunity to introduce evidence. And the basic reasons which support this general principle applicable to trial courts make it equally desirable that parties should have an opportunity to offer evidence on the general issues involved in the less formal proceedings before administrative agencies entrusted

[4] Cf., e. g., Helvering *v.* Hormel, 111 F. (2d) 1 (the decision below), with Helvering *v.* Richter, 114 F. (2d) 452, reversed this day.

[5] The Board's rulings on questions of law, while not as conclusive as its findings of fact, are nevertheless persuasive, and it is desirable that a reviewing court have the benefit of such rulings. See Helvering *v.* Wood, 309 U. S. 344, 349; Helvering *v.* Tex-Penn Oil Co., 300 U. S. 481, 498. This is true not only of the Board of Tax Appeals but of other administrative bodies as well. Cf. Federal Trade Commission *v.* R. F. Keppel & Bro., 291 U. S. 304, 314.

with the responsibility of fact finding. Recognition of this general principle has caused this Court to say on a number of occasions that the reviewing court should pass by, without decision, questions which were not urged before the Board of Tax Appeals. But those cases do not announce an inflexible practice, as indeed they could not without doing violence to the statutes which give to Circuit Courts of Appeals reviewing decisions of the Board of Tax Appeals the power to modify, reverse or remand decisions not in accordance with law "as justice may require." There may always be exceptional cases or particular circumstances which will prompt a reviewing or appellate court, where injustice might otherwise result, to consider questions of law which were neither pressed nor passed upon by the court or administrative agency below. See *Blair* v. *Oesterlein Machine Co.*, 275 U. S. 220, 225.

Rules of practice and procedure are devised to promote the ends of justice, not to defeat them. A rigid and undeviating judicially declared practice under which courts of review would invariably and under all circumstances decline to consider all questions which had not previously been specifically urged would be out of harmony with this policy. Orderly rules of procedure do not require sacrifice of the rules of fundamental justice. And examination of the cases relied upon by petitioner discloses that this Court, in following in some cases the general principle sought to be invoked here by petitioner, has been careful to point out the circumstances justifying application of the practice in the particular case. Thus, for example, we held in *Helvering* v. *Wood*, 309 U. S. 344, 348-349, that the government could not present in this Court as a wholly new issue the applicability of section 22(a). But we there especially relied upon the fact that the government, when the case was before the Circuit Court of Appeals, had made an express waiver of any reliance upon 22(a). In *Helvering* v. *Tex-Penn Oil Co.*, 300 U. S. 481, 498, this Court declined to consider a newly presented question, but pointed out that it had not been raised by the Commissioner either in his notice of tax deficiency, in his appearances before the Board of Tax Appeals or the Circuit Court of Appeals, or in his petition for certiorari to this Court. And in *General Utilities & Operating Co.* v. *Helvering*, 296 U. S. 200, 206-207, though this Court said that the Circuit Court of Appeals should not have considered a contention not presented to or ruled upon by the Board of Tax Appeals, the statement was buttressed by adding that the Circuit Court of Appeals

had "made an inference of fact directly in conflict with the stipulation of the parties and the findings, for which we think the record affords no support whatever. To remand the cause for further findings would be futile. The Board could not properly find anything which would assist the Commissioner's cause." The plain implication of that decision was that the cause would have been remanded to the Board of Tax Appeals had the Court considered the newly raised point to be of sufficient merit. These decisions and others like them, while recognizing the desirability and existence of a general practice under which appellate courts confine themselves to the issues raised below, nevertheless do not lose sight of the fact that such appellate practice should not be applied where the obvious result would be a plain miscarriage of justice. Analogous in principle is the philosophy which underlies this Court's decisions with relation to appellate practices in other cases: those in which it has been held that a decision of the Board of Tax Appeals can be supported in the reviewing court on a new theory of law;[6] those which have been remanded because the lower courts failed to give consideration to a phase of the case involving legal theories not presented;[7] and those in which there have been judicial interpretations of existing law after decision below and pending appeal—interpretations which if applied might have materially altered the result.[8] Whether articulated or not, the philosophy underlying the exceptions to the general practice is in accord with the statutory authority given to courts reviewing decisions of the Board of Tax Appeals—decisions not in accordance with law should be modified, reversed or reversed and remanded "as justice may require."

In accordance with this principle, we are of opinion that the court below should have given and properly did give consideration to section 22(a) in determining petitioner's tax liability. The Commissioner urged this point before the Circuit Court of Appeals and has strongly presented it here. At the time the Board of Tax Appeals made its decision in this case, we had not yet handed down our opinion in *Helvering* v. *Clifford,* 309 U. S. 331, in which we held that under section 22(a) the income of certain trusts was taxable to respondent. The Circuit Court of Appeals was of

[6] E. g., Helvering *v.* Gowran, 302 U. S. 238, 246.

[7] E. g., United States *v.* Shelby Iron Co., 273 U. S. 571, 579; United States *v.* Rio Grande Dam & Irrigation Co., 184 U. S. 416, 423.

[8] E. g., Vandenbark *v.* Owens-Illinois Glass Co., No. 141 this Term, and cases there cited.

opinion that there were no controlling distinctions between the trusts created by petitioner in this case and those created by Clifford. Here, as there, control over the trusts was completely in the hands of the taxpayer and his wife. For while petitioner's trust instruments showed a co-trustee acting with petitioner, the same instruments also disclosed that such co-trustee could be removed at any time by the joint action of petitioner and his wife. "To hold otherwise [i. e., that petitioner is not subject to the tax] would be to treat the wife as a complete stranger; to let mere formalism obscure the normal consequences of family solidarity; and to force concepts of ownership to be fashioned out of legal niceties which may have little or no significance in such household arrangements."[9] As the record now stands we think the court below correctly concluded that the trust income was taxable to petitioner under the principles announced in the *Clifford* case. Therefore to apply here the general principle of appellate practice for which petitioner contends would result in permitting him wholly to escape payment of a tax which under the record before us he clearly owes. Thus viewed, this is exactly the type of case where application of the general practice would defeat rather than promote the ends of justice, and the court below was right in so holding.

But the Board of Tax Appeals neither found the facts nor considered the applicability of 22(a) in the light of the *Clifford* case. Congress has entrusted the Board with exclusive authority to determine disputed facts. Under these circumstances we do not feel that petitioner should be foreclosed from all opportunity to offer evidence before the Board on this issue, however remote may be his chance to take his case out of the *Clifford* rule.[10] Accordingly, the judgment of the lower court reversing the decision of the Board of Tax Appeals is affirmed, with directions to the Board of Tax Appeals for further proceedings in accordance with this opinion.

It is so ordered.

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[9] Helvering *v.* Clifford, 309 U. S. 331, 336-337.

[10] In this connection petitioner pointed out in his brief before the Circuit Court of Appeals that "If any contention whatsoever had at any time been suggested or considered as to Section 22, the matter of the evidence introduced or to be introduced would have required further consideration."